Dechert LLP

INITIAL REPORT OF THE INDEPENDENT INVESTIGATOR

DECEMBER 5, 2005

Dechert LLP

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1. INTRODUCTION

This Report[2] contains the initial findings of the investigation regarding whether the Mayor, Mayor's staff, or other City officials, officers or employees violated the City Charter, Municipal Code, the City's Independent Judgment Policy, or other laws with respect to the matters specified by the Santa Clara County Civil Grand Jury.[3]

2. BACKGROUND RE SUBJECT OF INVESTIGATION

A. General Summary Of The Findings Of The Grand Jury.

The present investigation arises out of the findings of the Santa Clara County Civil Grand Jury (the "Grand Jury") regarding the alleged conduct of certain City of San Jose officials relating to the award of a 2002 Recycle Plus! Agreement by the San Jose City Council (the "City Council") to Norcal Waste Systems, Inc. ("Norcal"), the 2004 Amendment of the 2002 Recycle Plus! Agreement (the "2004 Amendment"), and to certain Recycle Plus! rate increases passed by the City Council.

Generally, the conclusions of the Grand Jury center on its findings that Mayor Ron Gonzales (the "Mayor") and his Budget and Policy Director, Joe Guerra, (1) knew before the City Council voted to award the 2002 Recycle Plus! Agreement to Norcal that Norcal would incur additional labor costs that were not reflected in the bid it submitted to the City Council for consideration, and (2) that the Mayor privately assured Norcal and its subcontractor that the City of San Jose would reimburse Norcal for these additional labor costs. The Grand Jury found that neither the Mayor nor Mr. Guerra disclosed these facts to the City Council and, in fact, concealed them. *See* 2004-2005 Santa Clara County Civil Grand Jury Report: *San Jose Trash Deal—How The City Was Duped Into Wasting $11.25 Million* (the "Grand Jury Report"; Appendix A-3), at pp. 1-2.[4]

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[2] This Report was prepared with the substantial assistance of Dechert LLP attorneys Daniel McCloskey and Chris Burdett, both of whom reviewed and analyzed the information presented and provided significant contribution to development of the legal and factual issues addressed herein.

[3] In the materials provided to assist in this investigation were numerous documents described by the City as containing information that falls within the attorney client privilege, and which were provided to the Investigator with the direction that they be maintained confidential. *See* Appendix A-1. As it is not within the scope of this investigation to determine whether such materials are within the scope of the attorney client privilege, or whether the privilege should be waived, and since the materials were considered (and quoted in part herein) as a part of the investigation, as directed by the City of San Jose the Investigator leaves it to the City Council to decide whether (and to what extent) to disclose those materials and the contents of this Report to the public. *See also* Memorandum of Richard Doyle to City Council dated October 20, 2005 (Appendix A-2).

[4] The Grand Jury, in its Grand Jury Report, concluded that the Mayor made the following affirmative misrepresentations:

> (a) that the increased costs were unanticipated prior to the October 10, 2000 vote, when in fact they were anticipated; (b) that the Mayor found out about the increased costs after the October 10, 2000 vote to approve Norcal as a vendor, when in fact he knew beforehand; (c) that the proposed nine percent garbage rate increase in FY 2003-2004 was needed for reasons other than to reimburse Norcal; and (d) that the Mayor stated that there would be no garbage rate increases as a result of the Council's decision to pay Norcal the $11.25 million, when other City representatives have admitted that further increases would be required to fund the $11.25 million payment to Norcal.

The Grand Jury further concluded that the Mayor and Mr. Guerra failed to disclose to the City Council, and in fact concealed from it and the public, that subsequent rate increases for the Recycle Plus! Program were in fact for the purpose of funding payments by the City of San José to Norcal for the additional labor costs, rather than due to deteriorating economic conditions and other factors presented to the City Council and the public as a basis for the increased rates. *Id.* at p. 2.[5] The Grand Jury also concluded that the Mayor interceded in a labor dispute on behalf of the Teamsters Local 350, and suggested that the alleged interference may violate federal labor law. *Id.* Finally, the Grand Jury questioned whether payment by the City Council of the additional labor costs to Norcal constituted an illegal gift of public funds.

In addition to the findings and conclusions as specified in the Grand Jury Report, the Grand Jury recommended "that an independent special investigator be retained to take statements under oath, obtain all of the documents, and then decide who acted inappropriately, and what sanctions should be sought." *Id*. at p. 2.[6]

B. Scope of Initial Investigation.

In response to the recommendations of the Grand Jury, the City Council began the process of proceeding with an independent investigation of the matters addressed in the Grand Jury Report.[7] Pursuant thereto, on June 28, 2005, the City Council directed the City Auditor to select an investigator to review issues associated with the 2002 Recycle Plus! Agreement and the 2004 Amendment of the 2002 Recycle Plus! Agreement.

Pursuant to the directions of the City Council, as provided in the Investigator's memo to the City Council dated September 12, 2005 (Appendix A-4) and thereafter approved by the City

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[5] The Grand Jury, in its Grand Jury Report, alleges that the Mayor made the following omissions or concealments:

> For a period of almost four years, between October 2000 and early September 2004, the Mayor and his Policy and Budget Director concealed from the Council: (a) the occurrence of the October 6, 2000 "backroom discussion" the Mayor had with Norcal and CWS; (b) the Mayor's October 6, 2000 assurance to Norcal and CWS that the Mayor would take the steps necessary to have San Jose pay the increased costs; (c) that the increased costs were known and anticipated prior to the Council's October 10, 2000 vote; (d) that Norcal was willing to take less than the $11.25 million it requested; (e) that the primary purpose of the proposed nine percent garbage rate increase in FY 2003-2004 was to cover the increased costs to Norcal; and (f) that the threatened strike by the Teamsters in February 2003 was primarily caused by the Mayor's delay in asking the Council to pay Norcal the $11.25 million.

[6] While the investigation did not address the issue raised by the Grand Jury of "what sanctions should be sought," for purposes of further consideration the following principles are noteworthy:

(a) The State Civil Service Act provides for disciplinary action against certain government employees. *See* Cal. Gov't Code § 19570 (defining the employees covered by the State Civil Service Act). However, pursuant to California Government Code § 45001, a city may adopt its own civil service system which governs the disciplinary actions of employees of the city. Cal. Gov't Code § 45001 ("By ordinance, the legislative body of any city may establish a personnel system, merit system, or civil service system for the selection, employment, classification, advancement, suspension, discharge, and retirement of appointive officers and employees").

(b) The San Jose City Charter creates a civil service system, pursuant to Article XI, and therefore its provisions apply over the provisions of the State Civil Service Act. *See Baumgardner v. Hawthorne*, 104 Cal. App. 2d 512, 517 (1951) ("No employee of the city having civil service status may be discharged in any manner other than as expressly provided in [the local civil service act]"). However, the City Charter itself is currently silent on disciplinary action -- Section 1104 of the City Charter, pertaining to disciplinary action, was repealed in 1998.

[7] *See* San Jose City Charter ("City Charter") Section 416. Appendix B-1.

Council during its September 13, 2005 session (Appendix A-5), the scope of this initial investigation is limited to a comparison of the Grand Jury's factual analysis, as set forth in its Report, with the source materials supplied to the Investigator, to address whether there is credible evidence sufficient to support the conclusion that the Mayor, Mayor's staff, or other City officials, officers or employees (sometimes collectively referred to as "City staff") violated the City Charter, Municipal Code, City Policies related to ethics or independent judgment, or other laws. In connection therewith, to the extent consistent with the foregoing, the Investigator has addressed (as discussed below) the questions specified by City Council Member Chuck Reed in his Memorandum dated September 6, 2005 (Appendix A-6), and by the Mayor in his Memorandum dated September 20, 2005 (Appendix A-7). The purpose of this investigation is also to determine the extent to which further factual investigation is warranted or appropriate with regard to the findings of the Grand Jury in light of the limited scope of information made available to the Investigator during this initial phase.[8]

3. SUMMARY OF INITIAL CONCLUSIONS/FINDINGS

The Independent Judgment Policy of the City of San Jose (the "Independent Judgment Policy"; Appendix B-2) was enacted to "ensure that the recommendations made and administrative actions taken by the City staff reflect the independent professional judgment of that staff and that only the official policies and positions of the City Council are represented as such." Independent Judgment Policy, Policy No. 0-26, at 1. The Independent Judgment Policy further provides, *inter alia*, that: "[n]o individual member of the City Council shall present his or her views as being the view of the City or the City Council unless that view reflects an official City position or the member has been officially authorized by the City Council to speak on behalf of the City." *Id.* at 2.

In the absence of specific statutory or other authority proscribing or mandating certain acts by City staff, the over-riding legal issue which underlies this Investigation is whether the acts and omissions alleged by the Grand Jury to have been committed by the Mayor and Mr. Guerra, and/or other City staff, violate the letter or intent of the Independent Judgment Policy and/or the ethics standards set by the City of San Jose. Those ethics standards are set forth at Section 204 of the City Charter (the "Ethics Standards"; Appendix B-3), which provides that:

> The citizens of San Jose expect and must receive the highest standard of ethics from all those in public service. City officers and employees must be independent, impartial and responsible in the performance of their duties and accountable to the members of the public.

From the limited scope of information reviewed to date, several conclusions arise that are material to the subject matter of the issues addressed by the Grand Jury:

A. At a minimum, there exists the appearance of impropriety on the part of the Mayor, coupled with a substantial lack of disclosure to the City Council of all relevant facts. These are situations that should have been – and could have been -- avoided by the Mayor and Mr. Guerra.

[8] See Section 4, below, describing the process of the initial investigation.

At a time when public confidence in the governmental operations of the City of San Jose is being continually buffeted by matters that leave serious questions as to the competency and honesty of locally elected officials and staff personnel, the interactions with Norcal and the handling of the issues that have arisen regarding the 2002 Recycle Plus! Agreement and the 2004 Amendment were not consistent with the structure of government as set forth in the City Charter or general concepts of "open government."

B. On several issues considered in the course of this investigation, the information in the documentation reviewed demonstrates that the Mayor, members of his staff, and members of City staff were acting on the basis that they had the right, and obligation, to make decisions and/or commitments on behalf the City of San Jose which were more properly decisions that were within the province of the City Council. For some of the decisions and/or commitments, the materials reflect a belief by some City staff that City Council approval was more of a formality, rather than a substantive process.

C. The materials reviewed demonstrate that there are many individuals within City staff who acted appropriately when faced with the demands by Norcal and California Waste Solutions, Inc. ("CWS") for additional funds to cover the increased labor costs, and attempted to raise questions or concerns on behalf of the residents of the City of San Jose as issues arose. However, at a minimum there was an overall failure to address those questions or concerns in a fashion that would have taken into account, or have been in the best interests of, all residents served by City government. Rather, the materials reviewed reflect a focus by senior members of City staff on finding ways to justify the additional payments to Norcal, and to avoid a claim that the payments were improper or a gift of public funds. While the materials reviewed are not definitive on this point, as it relates to the subject matter of this investigation, credible evidence exists to support the conclusion of a violation by the Mayor (directly, and through others on his staff) of the Independent Judgment Policy. In this regard, there is the absence of any documentation of any attempt by the Mayor or his staff either to pursue the questions or concerns raised by City staff regarding the legality or propriety of agreeing to make any additional payments to Norcal, or to direct City staff to challenge what had been clearly identified by some members of City staff as significant problems with acceding to the request from Norcal for more funds.

D. The materials provided contain credible evidence to support the conclusion that neither the City Council nor the public were appropriately informed of the reasons behind the 2003-04 rate increase. To the contrary, the materials confirm that the Mayor and his staff, and specifically Joe Guerra, misled the public and the City Council regarding their undisclosed intention to use part of the funds generated by the 2003-04 rate increase to reimburse Norcal for increased labor costs incurred by CWS.

E. While the materials reviewed to date provide credible evidence to support the conclusion that the Mayor and/or Mr. Guerra failed to disclose to the members of the City Council or other City staff information that was material to the relationship between the City and Norcal, additional investigation in the form of witness interviews is necessary to provide a more definitive conclusion. The purpose of obtaining witness testimony is to further explore the issues discussed

herein, and to consider any additional information that may contradict (or further support) the foregoing conclusions.

4. DESCRIPTION OF PROCESS OF INITIAL INVESTIGATION

A. Standard of Review

An investigation of this type is not an adjudicatory process. The Investigator has no binding authority to determine the existence or nonexistence of facts in dispute. There are no established standards applicable to guide the review of materials or by which to measure or weigh the information provided, nor is the concept of "burden of proof" applicable as the investigation was not carried out as part of an adversarial process.

As indicated herein, the Investigator's analysis and conclusions are predicated on a comparison of the Grand Jury source materials (and other documents provided by the City which may not have been considered by the Grand Jury) to the Grand Jury's conclusions to determine (1) the extent to which there is sufficient credible evidence to support the conclusion that the Mayor, Mayor's staff, or other City officials, officers or employees violated the City Charter, Municipal Code, City Policies related to ethics or independent judgment, or other laws, and (2) the extent to which further factual investigation is warranted.

B. Materials Reviewed

The Investigator reviewed several volumes of documents supplied by the City Auditor and City Attorney's offices, comprising over 14,500 pages. Among other things, the documents include transcripts of City Council meetings, City staff memoranda and reports, and correspondence and e-mails to and from the Mayor, his staff, and from City staff and outside individuals and entities. A general summary of the reviewed materials is set forth in Appendix A-8.[9] The Investigator was not permitted to review notes or memorializations of any statements provided by individuals to the Grand Jury, or to review any work papers or documents prepared by the Grand Jury, other than the Grand Jury Report.

C. Limitations

The investigation is not an adjudication of any issue, as the Investigator does not have the authority to issue binding determinations of law or fact. Further, none of the burdens of proof applicable in an adversarial proceeding were considered (neither the criminal standard of beyond a reasonable doubt, nor the civil standard of preponderance of the evidence). During this initial investigation informal witness interviews were not conducted, and the Investigator was not

[9] During the City Council meeting on September 13, 2005, City Council Member LeZotte asked for clarification regarding processing of any additional information that any member of the City Council felt the Investigator should have and consider as part of the investigation. In response to her inquiry, the City Council and the Mayor were asked to forward to the attention of the Investigator any such materials or, alternatively, provide confirmation that all such documents (including memos, e-mails, letters, calendars, personal notes) that may be in their possession, or in the possession of their staff, had been provided. Confirmation of the foregoing was provided by the Mayor and City Council Members Reed, Yeager, Williams, Pyle, LeZotte, Chirco, Chavez and Campos (Ms. Nguyen, recently elected, was not expected to have any materials relevant to this inquiry).

provided with the independent authority to compel witnesses to testify or subpoena documents.[10] Rather, the purpose of this investigation is to provide an independent review of the factual and legal issues raised and considered by the Grand Jury in order to provide the City Council with an objective and unbiased review of the Grand Jury's conclusions.

5. RELEVANT LEGAL AUTHORITIES CONSIDERED

The Investigator reviewed the following legal authorities in connection with the initial phase of the investigation:[11]

- San Jose City Charter
- San Jose Municipal Code
- San Jose Independent Judgment Policy
- California Government Code
- California Constitution
- California case law interpreting the foregoing authorities and additional relevant legal principles

6. SUMMARY OF RELEVANT FACTS.

The facts surrounding the alleged activities are convoluted and span several years. Therefore, a review of the relevant facts, as gathered from the limited materials reviewed in connection with this investigation, is warranted and a summary follows below.[12] By summarizing the facts for the purposes of this Report, the Investigator is not suggesting that other facts reflected within the materials considered are not relevant, or that there is an absence of other facts that are (or may be) relevant to the analysis.

A. The Competitive Bidding Process for Recycle Plus! Contracts.

In the late 1990s, the City Council approved the development of a process to solicit proposals for the provision of waste management and recycling services to the City and to award contracts for the City's Recycle Plus! program based on a competitive bidding process (a.k.a, the "RFP" process). Council Meeting Minutes, at p. 15 **(**May 5, 1998; Appendix A-10); and p. 18 (Dec. 7, 1999; Appendix A-11). The objective was to produce an "open, methodical and documented process which protects the City from allegations of unfairness and political preference." Memo from Carl Mosher to City Council, at p. 5 (Oct. 6, 1999; Appendix A-12).

[10] In light of the of the detailed and contemporaneous memorialization of events contained in the extensive documentation provided to the Investigator, and the lack of probative value inherent in informal witness interviews (i.e., interviews were the witness is not under oath and the statements are not transcribed by a certified shorthand reporter), the Investigator defers to the City Council on the question whether to pursue formal witness interviews under oath as a part of any further investigation into these matters.

[11] Relevant portions of the City Charter, San Jose Municipal Code, City Council Independent Judgment Policy and information relating to the San Jose elections Committee are summarized or noted in Appendix B-4. Other authorities mentioned or considered as a part of the initial investigation are cited herein.

[12] A timeline reflecting some of the significant events addressed herein is included. Appendix A-9.

During 1999 and early 2000, the City Council adopted guidelines to govern the RFP process, established criteria for evaluating the proposals, and determined the factors that would be of paramount importance in considering the competing bids. Reports to the City Council by the Environmental Services Director, Carl Mosher, stressed that the key considerations in assessing the anticipated proposals would be "cost, customer service and waste diversion." Memo from Mosher to City Council, at p. 1 (Jan. 21, 2000; Appendix A-13). Additionally, Mr. Mosher as well as numerous City Council members identified "worker retention" and "labor peace" as important factors in evaluating the RFP's. Toward this end, the City Council resolved that the proposers would be required to provide with their bid information regarding their relations with workers, as well as assurances of their commitment to labor peace. Council Meeting Transcript ("CMT"), at p. 15 (Jan. 25, 2000; Appendix A-14); Memo from Mosher to City Council, (Jan. 21, 2000; Appendix A-15). The City Council further required that the agreements entered into with the selected contractors include provisions requiring the payment of prevailing wages in accordance with the City's prevailing wage statute. CMT, at p. 15.

The City Council also adopted process integrity guidelines "to ensure fair competition." Staff Presentation re Recycle Plus! RFP (Jan. 11, 2000; Appendix A-16); Memo from Mosher to Honorable Mayor and City Council re Recycle Plus RFP, at Attachment A (Dec. 2, 1999; Appendix A-17). These guidelines mandated that "[a]ll RFP-related communication with the City of San Jose prior to the release of the Staff's recommendation on the award of contracts must be through Carol Reed, Purchasing Division. Communication to the City should be in writing by fax, e-mail or mail..." *Id.*

In a Memorandum dated April 4, 2000, from the Mayor and then Vice-Mayor Frank Fiscalini to the City Council, the authors cautioned against providing contractors with easy opportunities to amend city contracts and to seek rate increases. Thus, it was noted that:

> Compensation Adjustment
>
> Some Councilmembers suggest that we may choose to re-open the contract in the event of a change in collective bargaining agreements. *We believe this suggestion will create an opportunity to easily or regularly raise Recycle Plus rates and cannot recommend its adoption.* Current contracts account for reasonable wage increases. Employers who wish to increase wage rates higher than anticipated may do so. We believe that current RFP language best protects the interest of the City and our rate-paying customers.

Appendix A-18, at p. 2; (emphasis added).

On June 27, 2000, the City Council approved guidelines for weighting the criteria to be used to evaluate the anticipated proposals. CMT, at p. 17 (June 27, 2000; Appendix A-19). The criteria were separated into two tiers. Memo from Mayor Gonzales *et. al*. to City Council Members re Recycle Plus! RFP Evaluation Criteria (June 26, 2000; Appendix A-20). Tier 1 included cost evaluation, customer service, experience and strength of operations. *Id.* at p. 1. Tier 2 included business risk and technical capability *Id.* Tier 1 factors were to be accorded greater weight than Tier 2 factors. *Id.* at p. 2.

The City Council established three committees to review the proposals. The Staff Panel, consisting of staff professionals from various City departments, including Environmental Services, Streets and Traffic, Finance and the City Attorney's office; the External Panel, consisting of "leaders from the western U.S., including representatives from the City of Phoenix, Portland, Seattle and Tacoma, and the County of Santa Cruz, and the City Executive Committee, consisting of Directors from the departments of Environmental Services, Streets and Traffic and Finance, the Director of the Office of Equality Assurance, and the Senior Deputy City Manager." Attachment B to Memo from Del Borgsdorf to City Council (Sept. 22, 2000; Appendix A-21).

On April 28, 2000, the City released the RFP to the public. The deadline for submitting proposals responsive to the RFP was July 14, 2000. Memo from Mosher to Mayor and City Council Re: Selection of Contractors for Recycle Plus!, (Sept. 22, 2000; Appendix A-22).

B. Norcal's Bid.

Norcal was among seven companies bidding for Recycle Plus! contracts. Memo from Mosher to Honorable Mayor and City Council re Selection of Contractors for Recycle Plus, at p. 3 (Sept. 22, 2000; Appendix A-22).

On September 22, 2000, Mr. Mosher issued recommendations to the City Council regarding which proposals the City Council should accept. *Id.* at p. 1. Mr. Mosher recommended that the City Council award the contracts for Single Family Garbage and Recycling Collection and Processing for Districts A and C to Norcal. *Id.* Mr. Mosher recommended that the City Council award the Green Team of San Jose the contract for District B. Mr. Mosher further recommended that the City Council award the Yard Trimmings Collection and Processing and Residential Street Sweeping contracts to Norcal for District C, and to Green Waste Recovery for Districts A and B. *Id.*

In his memo to the City Council, Mr. Mosher summarized each of the proposals, including the proposal from Norcal. *See id.*, at Attachment D. The memo addresses a variety of factors regarding Norcal's company, its operations, and its proposal. *Id.* The summary notes, *inter alia*, that Norcal's subcontractor, CWS, had agreements with both the Longshoremen Local 6 Union and the Teamsters Local 70 and that there "would be no union transition required." *Id.* The memo further states that CWS will "extend the [Teamster's] agreement to San Jose as well, or will establish a collective bargaining agreement with [Teamster's] Local 350 if the two Locals so desire." *Id.* No mention is made in the memo of wage disparities between the Teamsters and Longshoremen, and/or the impact of any dispute between the two on anticipated labor costs under Norcal's proposal.

On October 8, 2000, the Mayor, Vice-Mayor Fiscalini and City Council Members Chavez, Dando and Powers endorsed the staff recommendations regarding selection of the contractors for the Recycle Plus program. Memorandum from Mayor Gonzales *et. al.* to City Council re Selection of Contractors for Recycle Plus (Oct. 8, 2000; Appendix A-23). The Mayor's Memorandum sets forth a recommendation, among other things, that the City Council authorize an audit of the selected proposals by the City Auditor and further recommended that the City Attorney clarify the City's policies regarding "prevailing wage, employee retention and labor

peace" and that the City Council "ensure that these policies are included in the negotiated contract." *Id.* at p. 2.

Subsequently, questions were raised regarding the "soundness" of Norcal's proposal. Memo from Carl Mosher to Honorable Mayor and City Council re Review of Norcal Proposal (Oct. 10, 2000; Appendix A-24).[13] Mr. Mosher advised the City Council that a consulting firm that had been helping the City staff evaluate the proposals conducted a further review of the Norcal proposal. *Id.* Mr. Mosher reported that the firm had confirmed that the "assumptions used by Norcal are reasonable in relation to the services to be provided and comparable industry standards, and that the disparity in the proposed SFD rates between Norcal and the other proposers is consistent with national trends during a competitive RFP process." *Id.*

C. Events Leading Up To City Council Award of Agreement to Norcal.

At the center of the controversy that led to this investigation is a meeting between the Mayor and members of his staff and Norcal representatives which occurred four days before the City Council voted to award the Recycle Plus! contract to Norcal on October 10, 2000. Although there is no specific documentation of this meeting in the materials reviewed, the Mayor has now affirmed that he was personally present at an October 6, 2000 meeting with representatives of Norcal. Response to Grand Jury Report on Norcal Agreement, at p.12 (Sept. 1, 2005; Appendix A-26). It is not clear based on the materials reviewed who else may have participated in this meeting on behalf of the City, Norcal, or other entities, although the Response to Grand Jury Report seems to suggest that Mr. Guerra was present. *See id.* By all accounts, it appears that at least one of the subjects discussed at the October 6, 2000 meeting was a nascent labor union dispute that was then facing Norcal and its proposed subcontractor.

The Mayor contends that on October 3, 2000, the Teamsters contacted the Mayor concerning a union jurisdictional dispute that had arisen between the Teamsters and CWS regarding representation of CWS employees working on the Norcal contract. (*See id.* at p. 3, Appendix A-26.[14]) The Teamsters filed a complaint against CWS with the National Labor Relations Board on October 5, 2000. Although the Investigator has not had the benefit of reviewing the pleadings, discovery and other materials relevant to the Teamsters' NLRB action, it appears that the Teamsters sought to challenge CWS' ability to have its employees work on the Norcal contract under an existing collective bargaining agreement with the Longshoremen (also sometimes referred to as "ILWU") without providing the employees the option of choosing representation by the Teamsters.

On October 4, 2000, David Duong of CWS wrote the Mayor and explained that he had committed to the Longshoremen union that "any expansions of my recyclables processing

[13] The information provided indicates that the City received a number of assurances from a variety of sources regarding the financial status of Norcal for the time periods in question. *See* Appendix A-25.

[14] Although the Response to the Grand Jury Report refers to correspondence dated October 3, 2000 from the Teamsters to the Mayor, such correspondence was not among the materials provided to the Investigator. The received materials do include, however, correspondence from David Duong of CWS to the Mayor, dated October 4, 2000, and in which Mr. Duong asserts CWS' "commitment" to the Longshoremen's union. Duong letter to Mayor Gonzales [Oct. 4, 2000, Appendix A-27.

business will include their union." Duong letter to Mayor Gonzales (Oct. 4, 2000; Appendix A-27). On the same day, Norcal also sent via facsimile a letter to the Mayor, in which the potential dispute between various unions relating to worker retention and representation is identified. Appendix A-28. Enclosed therewith was a letter from Norcal to Teamsters Local 350. Appendix A-29. In addition, ILWU Local 6 sent its own correspondence (via facsimile, U.S. Mail and Certified Mail) to the Mayor advising the Mayor of its position. Appendix A-30.

On October 5, 2000, Norcal advised the Mayor via letter that Norcal recognized Teamsters Local 350 as the agent for its union employees, and that the employees of CWS were covered by a collective bargaining agreements with Teamsters Local 70 and ILWU Local 6. Appendix A-31.

The Mayor asserts that, at the October 6, 2000 meeting, among other issues, "the union jurisdictional issue was discussed in the context of the Council's goal of achieving labor peace and avoiding potential disruptions in service. *There was no discussion of the potential wage differential between Longshoremen and Teamsters workers*." Response to Grand Jury Report on Norcal Agreement, at p.13 (Sept. 1, 2005; Appendix A-26), (emphasis added). By contrast, the Grand Jury Report alleges that the Mayor and Mr. Guerra knew that CWS would have to pay Teamsters wages at an additional cost of $2 million per year and that the "Mayor assured Norcal and CWS that he would take steps necessary to see that San Jose paid the increased costs." Grand Jury Report, at pp. 22-23, Appendix A-3.

The dispute between the Teamsters and CWS was ultimately resolved (at least temporarily) in part by CWS entering into a neutrality agreement pursuant to which workers had the option of choosing union representation by the Teamsters, rather than solely by the Longshoremen.[15] CMT, at pp. 16-17 (Oct. 9, 2001; Appendix A-32).

On October 9, 2000, CWS and Norcal executed an addendum to their contract which was clearly designed to address the cost implications of the labor dispute. *See* Addendum to Agreement Between Norcal Waste Systems, Inc. and California Waste Solutions, Inc. for Processing Residential Recyclables from the City of San Jose (the "Addendum"; Appendix A-33. The Addendum recites, *inter alia*, that Norcal "desires that CWS agree to the wage and benefit package required by the City of San Jose, and is willing to reimburse CWS any difference in cost. CWS is willing to agree to a higher wage and benefit package provided Norcal reimburses CWS for the difference in cost." *Id.* After this recital, Norcal and CWS agreed that:

> Norcal shall pay to CWS an amount equal to the difference between the amount of all wages and benefit costs (including, without limitation, wages, benefits, workers compensation premiums as related to the higher payroll, payroll taxes, and vacation and sick leave costs) for bargaining unit employees processing materials pursuant to the San Jose RFP and the amount of wages and benefits required to be paid in CWS's agreement with ILWU Local 6, as in effect at July 1, 2002, for similar work.

[15] A further investigation of this matter would require a review of the pleadings and discovery materials, including any depositions and sworn declarations, generated in connection with the Teamsters' NLRB complaint and the resolution of that action.

Id. (emphasis added).[16] The Addendum further provides that "CWS agrees that it will contact the City of San Jose and advise the City that it will pay the wage and benefit packages required by the City of San Jose." *Id.*

Also on October 9, 2000, CWS in fact contacted the Mayor to advise that it would be paying "sorter's hired pursuant to the City of San Jose's Recycle Plus contract award, wages and benefits at least equivalent to those presently paid to workers occupying these positions under the current agreements in San Jose." Appendix A-33.

City Council hearing transcripts for October 10, 2000, as well as contemporaneous City staff memos to the City Council, indicate that the City Council was aware, before voting to award the contract to Norcal, that the Teamsters and Longshoremen unions held competing claims to representing employees of CWS. CMT, at pp. 20, 26 - 27 (Oct. 10, 2000; Appendix A-36). Indeed, at the hearing, officials from both unions addressed the City Council. Teamsters officials argued that CWS should enter into a neutrality agreement which would allow its workers to be represented by the Teamsters, while a Longshoremen representative pled for CWS to "uphold" the collective bargaining agreement it had entered into with his union. *Id.* at pp. 27, 34-35. Whether the City Council (other than the Mayor) specifically recognized (or were advised of) the significance of this conflict as it relates to wages and labor costs, and when, is a critical, currently unresolved question.[17]

In an October 8, 2000 memo to the City Council, the Mayor, along with Vice-Mayor Fiscalini and City Council Members Chavez, Dando and Powers, endorsed the city staff recommendations for selection of contractors for the Recycle Plus! program, including Norcal. Memo from Mayor Gonzales *et. al*. to City Council re Selection of Contractors for Recycle Plus! (Oct. 8, 2000; Appendix A-38). The Mayor acknowledged concerns regarding the "operational and fiscal capacity" of the selected contractors to perform their proposed services, and recommended that the City Auditor conduct an audit of the winning bids. *Id.* at p. 3. The memo does not reference the union jurisdictional dispute or the potential wage differential that was central to that conflict.

On October 10, 2000, the City Council voted to award a 2002 Recycle Plus! Agreement to Norcal. CMT, at p. 37 (Oct. 10, 2000; Appendix A-36). Neither the discussion at the hearing nor the memos to the City Council includes mention of the Addendum. Nor does the transcript indicate an understanding, recognition or concern by the City Council, the Mayor or City staff of the additional labor costs that were not allegedly taken into account in Norcal's bid but that would

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[16] In 2003 CWS confirmed to the City its understanding that Norcal was obligated to pay CWS for "excess labor expenses that Norcal is obligated to pay CWS under a written contract." *See* Memorandum from CWS to Norcal, Carl Mosher and others, Attachment B to Memorandum from Carl Mosher to Richard Doyle dated August 11, 2003; Appendix A-34.

[17] In his Memorandum dated September 1, 2005 (Appendix A-26), the Mayor confirms that his office became aware of the potential for increased labor costs "in the weeks following the October 10, 2000 Council meeting." *Id.*, at p. 7. The Mayor goes on to state that "[a]though there are no records of when we learned about this, our recollections are it was in the period between October and December that my staff had preliminary discussions with Norcal about potential cost increases." *Id.* The Investigator's review of the records has determined that, by letter dated October 18, 2000, representatives of Teamsters Local 350 specifically warned the Mayor of the prevailing wage issue. Appendix A-37. What is not clear is when the Mayor first advised the City Council of this situation.

be incurred as a result of CWS agreeing to offer the wage and benefit package sought by Norcal and the Teamsters.

D. Audit of Selected Bids and Clarification of Prevailing Wage Policies.

Pursuant to the direction of the City Council, the City Auditor (Gerald Silva) audited each of the selected contractors' bids. Although the audit confirmed that the contractors' bids would result in a net savings to the City over continuing the existing contracts, it identified a number of errors and false assumptions which led the City Auditor to revise cost projections for the program upward. *See* A Review of the Recommended Contactors for the Recycle Plus 2002 Program, at p. 1, (Dec. 2000; Appendix A-39; Memo from Mayor Gonzales *et. al*. to City Council re Recycle Plus! Contractors Selection, (Dec. 8, 2000; Appendix A-38). It is not clear from the materials reviewed how the City Auditor analyzed the projected labor costs in the Norcal bid, and specifically how he accounted for the disparity between the pay scales for Longshoremen and Teamsters workers, or if he did so.

The City Auditor concluded that rate increases would be necessary in the future to bring the Recycle Plus! program toward cost recovery, but noted that rate increases could be deferred until 2004. *See* A Review of the Recommended Contactors for the Recycle Plus 2002 Program, at p. 1, (Dec. 2000; Appendix A-39).

Additionally, the City Attorney (Richard Doyle) published a memo which sought to clarify the City's policies regarding prevailing wage, employee retention, and labor peace issues as they relate to the Recycle Plus! program. Memo from Richard Doyle to Council re Recycle Plus!-Labor Issues, (Oct. 27, 2000; Appendix A-40). In the memo, Mr. Doyle addressed the issue of neutrality agreements and whether the City should require such provisions in its contracts with the selected contractors. Mr. Doyle explained that he was opposed to such agreements in part because they could constitute improper interference in the collective bargaining process, thus potentially violating federal law. *Id.* at pp. 1-2. The City Attorney further noted that, with regard to Norcal and CWS, the City had "little City business or justification" in seeking to require a neutrality agreement because both were represented by labor organizations. *Id.* at p. 2.[18]

The City Council subsequently voted to authorize the City Manager to negotiate agreements with the selected contractors, including Norcal. CMT, at p. 26 (Dec. 12, 2000; Appendix A-41).

E. The Original and First Amended Agreement Between the City and Norcal.

On March 27, 2001, pursuant to approval from the City Council, representatives of the City and Norcal entered into the 2002 Recycle Plus! Agreement. Appendix A-43. The following provisions of the 2002 Recycle Plus! Agreement are relevant to the present inquiry:

[18] Application of prevailing wage determinations as it relates to waste disposal contracts had been discussed amongst City staff on prior occasions. In an e-mail dated December 10, 1999, from Nina Grayson to Mr. Mosher among others, the following conclusion was stated: "if the off-site work is done in established off-site shop, open to the public and not established for and limited to the 'public works' project, the off site work is not covered" by the prevailing wage determinations. Appendix A-42.

- §17.02. Prevailing Wages. Norcal "shall pay prevailing wages to all drivers of collection vehicles performing collection of Residential Waste or Recyclable Materials pursuant to this Agreement."
- §17.02.3 No Compensation Adjustment. Norcal "shall not be entitled to any adjustments in the compensation paid to [Norcal] by City under this Agreement as a result of any adjustment of the wage rates which [Norcal] is required to pay its employees pursuant to the Prevailing Wage requirement."
- §17.04. Subcontractors. Norcal "shall ensure that any subcontractor who provides services under this agreement shall pay Prevailing Wages to any person employed or retained by the subcontractor to drive a collection vehicle."
- §24.11. "[Norcal] shall be responsible for directing the work of [Norcal's] subcontractors and any compensation due or payable to [Norcal's] subcontractor(s) shall be the sole responsibility of [Norcal]."
- §24.24. Entire Agreement. "This Agreement and the Exhibits attached hereto constitute the entire agreement and understanding between the parties hereto, and this Agreement shall not be considered modified, altered, changed or amended in any respect unless in writing and signed by the parties hereto. This Agreement includes all prior negotiations, correspondence, conversations, agreements and understandings applicable to the matters contained in this document. Accordingly, it is agreed that no deviation from the terms of this Agreement shall be predicated upon any prior representations or agreements, whether oral or written."
- Exhibit 11. CWS is identified as an approved subcontractor.

Each of the four agreements the City entered into with the selected contractors, including Norcal, were subsequently amended for the purpose of making "adjustments" due to "economic, programmatic and legislative changes." Mosher Memo to Council re Approval of the First Amendments to the 2002 Recycle Plus! Agreements (May 20, 2002; Appendix A-44). These amendments ultimately increased the overall costs to the City by $159,700. Mosher Supplemental Memo re Approval of First Amendments to the 2002 Recycle Plus! Agreements (June 21, 2002; Appendix A-45). No provisions relevant to the present inquiry appear to have been modified as a result of these amendments.

F. Threatened Teamster's Strike.

In February 2003, the Teamsters threatened to walk off the job at the CWS facility. On February 19, 2003, the Teamsters briefly struck before returning to work the same day. Appendix A-46.

G. Subsequent Rate Increases.

Since the commencement of service under the new Recycle Plus! contracts in 2002, the City Council has approved several rate increases.

First, in 2002, Mr. Mosher recommended a 3% rate increase for single family dwellings and a 4% increase for multi-family dwellings. Mr. Mosher identified the following reasons as a basis for the increases: to cover the cost of living for the contractors, to ensure that the program is self-supporting, and to provide a fund balance sufficient to cover emergency and other contingencies. Memo from Mosher to City Council re Public Notice for Recycle Plus Rate Increases (Sept. 13, 2002; Appendix A-47). The rate increase was to be effective February 1, 2003. *Id.* The City Council approved the rate increase on December 17, 2002 (CMT, December 17, 2002, Appendix A-48).

In April 2003, Mr. Mosher recommended that the City Council issue a public notice which called for 9% rate increases to be effective July 1, 2003. Memorandum from Carl Mosher to City Council re Recycle Plus rate increase (April 3, 2003; Appendix A-49. In the memorandum, Mr. Mosher advises that "these proposed rate increases are needed to cover rising costs and to bring the Recycle Plus! Program closer to cost recovery, reduce reliance on other funding sources, particularly the General Fund." *Id.*, at p. 1. In the draft notice attached to Mr. Mosher's memorandum, the public was told that "[t]he proposed rate increase is needed to help make garbage and recycling services more self-supporting, minimize the amount of taxpayer funds required to support them, and cover rising costs since rates were last increased." Although not stated in the memorandum, in March 2003 City staff already had confirmed with Mr. Guerra that "Norcal fully understands that our portion of the new labor agreement is with the overall proposed rate increases." Appendix A-50.

In a memorandum dated May 7, 2003, from Mr. Mosher to the Mayor and City Council, it was recommended that the City Council hold a public hearing on the proposed rate increase for 2003-04. Appendix A-51, at page 1. The proposed 9% rate increase was described as being "designed to bring the SFD and MFD garbage and recycling programs closer to cost recovery in order to reduce reliance on other funding sources and is consistent with Council policy that programs be self-supporting whenever necessary." *Id.*, at p. 2. The City Council approved the rate increase on May 27, 2003 (CMT, May 27, 2003; Appendix A52).

H. Amendment of Norcal/CWS Agreement And Subsequent Pressure to Amend the 2002 Recycle Plus! Agreement.

On March 11, 2004, Norcal and CWS entered into a "Second Amendment to Subcontract" (the "Norcal/CWS Second Amendment"; Appendix A-53) which clarified the obligations of Norcal and CWS, *inter se*, as it relates to certain additional payments for labor costs which Norcal and CWS anticipated receiving from the City. The Norcal/CWS Second Amendment provides, in pertinent part, that Norcal and CWS were to jointly seek the additional payments from the City and further sought to determine how the payments were to be allocated as between Norcal and CWS. *Id.* Particularly relevant to this investigation, however, is the confirmation that the obligation to pay CWS for any increased labor costs remained with Norcal:

> In the event the City fails or refuses to pay the Additional Payments or any portion of the Additional Payments as and when each such Additional payment comes due under the Schedule of Additional payments, Norcal will pay such unpaid Additional payment or Additional payments to CWS directly, provided CWS is not in material breach of the Subcontract, as amended.

Id., paragraph 3, p. 3.

On April 5, 2004, Norcal (through John Nicoletti) hand delivered to Mr. Mosher and Mr. Willis a copy of the Norcal/CWS Second Amendment. Appendix A-54. As noted in the e-mail chain discussing the Norcal/CWS Second Amendment, Mr. Guerra "did not want a copy…", and neither Mr. Holgersson nor Mr. Mosher believed that it provided "any good reason to amend the contract" between the City of San Jose and Norcal. Appendix A-55.

Notwithstanding the foregoing, and in a manner that is inconsistent with the position articulated by the Mayor in April 2000 with respect to re-opening contracts in the event of a change in collective bargaining agreements (Appendix A-56 at p.2)**,** City staff began the process of reviewing the Norcal/CWS Second Amendment. In addition to the other concerns raised about the document, a clear contradiction between the Norcal/CWS Second Amendment and the 2002 Recycle Plus! Agreement was specifically identified by City staff. Thus, in an e-mail to Mr. Mosher dated April 27, 2004, Jordan Ciprian raised the following issue (among others):

> "Item d, page one of the amendment clearly contradicts the Agreement between the City and Norcal in that it requests the City amend the Agreement as follows: 'payments made by the City to Norcal would be increased for the purposes of paying certain wages and benefits to the workers who process the recyclables collected under the Recycle Plus Agreement.' This conflicts with articles 17.02.3 and more specifically with 24.11 of the Agreement…."

Appendix, A-56. Likewise, in an e-mail dated April 29, 2004, Susan Devencenzi, Senior Deputy City Attorney, noted (in commenting on the proposed response by the City to Norcal) that the City has no obligations under the Norcal/CWS Second Amendment. Appendix A-57. Other City staff expressed the same understanding.

By letter dated April 30, 2004, Mr. Mosher advised Norcal that "[a]lthough the Amendment mentions a proposed increase in payments from the City to Norcal under the Recycle Plus Agreement, there is nothing in the Recycle Plus Agreement that provides for such payments. Additionally, there is nothing in the Agreement that is binding or that imposes any obligations on the City." Appendix A-58. Likewise, in an e-mail dated May 6, 2004, the Civic Services Manager, Integrated Waste Management Division, concluded that "…under the terms of our agreement, the payments we make to Norcal clearly should have nothing to do with the wages paid to CWS's workers." E-mail from Skip Lacaze to Carl Mosher, *et al.* (May 6, 2004) (Appendix A-59). After noting that "…it appears that Norcal and CWS believe that the City is obligated to pay them the $2 million per year, and that this belief is based on understandings reached with staff from the Mayor's office in meetings with CWS and the Teamsters almost two years ago," in a prescient comment Mr. Lacaze also noted that "contract problems of a lesser magnitude in the early 1990s lead to criminal investigations…." *Id.*

Notwithstanding the concerns being raised by City staff, and in contradistinction to the philosophy he articulated in his April 2000 memorandum, as reflected in the materials reviewed the Mayor was intent on having the 2002 Recycle Plus! Agreement amended. As described by Mr. Mosher in an e-mail to Mr. Holgersson, Deputy City Manager, and Ms. Devencenzi, dated May 11, 2004 (Appendix A-60), during a Budget Study Session on May 10, 2004 regarding

Norcal, the Mayor's Budget and Policy Analyst (Lydia Tolles) asked "how fast can you get the Norcal Amendment to the Council?" Mr. Mosher further wrote that he advised Ms. Tolles that the amendment between Norcal and CWS did not provide any consideration to the City of San Jose above the services already being provided. *Id.*

In response, Ms. Tolles provided a list of what she described as "non-contractually required services supplied by Norcal, per Joe [Guerra]." *Id.* In describing this list to Mr. Holgersson and Ms. Devencenzi, Mr. Mosher observed that the "dollar amount of these 'non-contractually' required services is no where near the 'labor peace' amount and I can argue that some of these are not 'non-contractual.'" *Id.* Ms. Devencenzi agreed, noting specifically that labor costs "actually are required under the current agreement." Appendix A-61. When Ms. Tolles continued to follow up on the Norcal contract issue, she was specifically advised by Mr. Mosher (in an e-mail dated May 25, 2004; Appendix A-62) that, in addition to the fact that Norcal had not made a formal request to amend the contract, the City of San Jose had "not received any documentation to justify the sum of the additional payments or the consideration the City would receive if additional payments were made." Likewise, in an e-mail dated May 26, 2004, Mr. Holgersson (Appendix A-63) noted Mr. Guerra's "strong desire to move a contract amendment forward for Norcal Recycle Plus," but reiterated that "we expressed to you that up to this point Norcal has not presented any substantial justification as to why the City should consider a substantial increase to the multi-year Recycle Plus contract." Rather than respond to the points appropriately noted by Mr. Holgersson, Mr. Guerra responded via e-mail dated May 26, 2004:

> As I have pointed out to Rick [Doyle] and Del [Borgsdorf] by phone today, **we raised our customers' rates already to specifically cover this additional cost**. I believe I even still have the spread sheet Carl made up which showed the justification for the rate amount that as settled on.
>
> **It is disingenuous at best to now be questioning amending the contract. I'm terribly uneasy with us continuing to charge customers and keeping the money**. We either need to process this amendment sometime soon or refund the money to customers and lower their rates. I'd really like us to agree on a timeline when either the Administration or our office will bring one of those options to the Council for approval.

Appendix A-64 (emphasis added).

The documentation made available to the Investigator shows that not everyone on City staff agreed with Mr. Guerra's assessment. As stated by the City Attorney in a responsive e-mail dated May 27, 2004:

> Joe:
>
> As we discussed, we are willing to sit down ASAP with NorCal to find a solution**. I don't think, however, that it's disingenuous to raise questions over the amendment. As I remember, the Council did not raise rates to cover any specific additional costs, and there was nothing in the staff memo that mentioned this issue**. Council's action was to make the Recycle Plus! program closer to cost recovery (which apparently is still only at 91%).

Appendix A-65 (emphasis added).

In a response that raises for the Investigator more questions than it provides answers regarding the level of disclosure within governmental operations and between the Mayor's staff and the City Council, twenty minutes after receipt of the foregoing e-mail, Mr. Guerra acknowledges the accuracy of the recollections of the City Attorney and responds in a manner that illustrates his view that it was sufficient for City staff alone to have had knowledge of the detailed basis for the rate increase:

> "**you are correct that there was nothing in the memo to the council**, however several staff were aware of the $1.9 million number that was folded into the rates."

Appendix A-65; (emphasis added).

Documentation provided to the Investigator does not reflect when the City Council was first advised that all information regarding the prior rate increase had apparently not been provided for their review before their vote on the rate increase. In any event, the materials provided reflect continued pressure from the Mayor's staff to bring forward on the agenda of the City Council matters related to the "Norcal contract amendment." *See*, e.g., Appendix A-66. In response, the City Attorney continued to remind the Mayor's staff, Mr. Guerra and the Mayor directly that "based on what we have received to date from Norcal, the City has no legal obligation to grant an increase." *Id.*

I. Norcal Formally Seeks to Amend its Agreement with City.

On June 16, 2004, Norcal wrote to Mr. Mosher to confirm its request to amend the 2002 Recycle Plus Agreement "to account for certain labor costs of Norcal's subcontractor, California Waste Solutions, Inc. ("CWS"), has incurred, and will continue to incur, to operate its San Jose recycling facility." Appendix A-67. In this letter, in recounting the history behind its request, Norcal claimed that it had discussions with City staff in 2000, and that in October 2000 – prior to the execution of the 2002 Recycle Plus! Agreement – City staff committed to Norcal that the City would make additional payments to Norcal with respect to these increased labor costs. *Id.*, at p. 2. In his response dated June 25, 2004, Mr. Mosher states that "…neither my staff nor I were involved in the discussions you have described. The City Council did not authorize these discussions and any 'commitment' made by unnamed City officials are not binding on the City."[19] (Appendix A-68).

On July 22, 2004, Norcal submitted to Mr. Borgsdorf another written request for an amendment to the 2002 Recycle Plus! Agreement. Nicoletti letter to Borgsdorf (July 22, 2004; Appendix A-69). Norcal again asserted that an amendment was necessary to allow the City to reimburse Norcal for additional labor costs incurred by CWS which resulted from the wages CWS paid its workers under an agreement with the Teamsters. *Id.* Norcal suggested that CWS entered into the agreement to satisfy the City's goals of "protecting both the jobs and pay rates of existing

[19] From the materials reviewed the identity (or identities) of the individuals referenced in the June 16, 2004 correspondence from Norcal is not definitive. Other materials, referenced herein, suggest that Norcal was referring to the Mayor and Mr. Guerra.

workers," and that Norcal had agreed to reimburse CWS for the additional costs once they became known. *Id.* Although deleting the references to meetings in October 2000 appearing in its prior correspondence, Norcal asserted that "[t]he representatives of the Mayor's office overseeing these discussions advised Norcal . . . that once those costs were determined, Norcal should submit them to the City for an appropriate amendment to the Recycle Plus! Agreement." *Id.*

While Norcal did not submit its formal request for an amendment until July 22, 2004, as noted in part above, City staff had been looking at the issues for over a year. As reflected in internal e-mails between City staff, in the spring of 2003 City staff were receiving direction to "find a way to amend the contract with Norcal." E-mail from Steve Willis to Susan Devencenzi (March 5, 2003; Appendix A-70). At that time it was noted that "[w]hile the specific purpose of this amendment has not been determined, the likely result of a proposed amendment would be to increase the compensation to Norcal, presumably with some offsetting benefit to the City." *Id.* Likewise, an exchange of e-mails on March 21, 2003, between Mr. Mosher and Julie Shioshita, reflects efforts by City staff in conjunction with the City Attorney's office relating to the "Norcal Amendment." Appendix A-71.

On September 16, 2004, the Mayor, along with Vice-Mayor Dando and City Council Member Chavez, submitted to the City Council a Memorandum in which they recommended that the City Council authorize the City Manager and City Attorney to negotiate with Norcal an amendment that would provide for the payment of the additional labor costs being requested by Norcal. Memo from Mayor Gonzales, Vice Mayor Dando and Councilmember Chavez to City Council re Amendment to the agreement with Norcal for Recycle Plus services. Appendix A-72. The Mayor conceded that there was no "legal obligation" for the City to pay the additional costs, but that a "legitimate business case" could be made. Appendix A-72.[20] Among other things, and in contradiction to information contained in other documents discussed herein, including specific warnings from the Teamsters to the Mayor in October 2000 (Appendix A-37), in the September 16, 2004 Memorandum, the Mayor argued that the costs were "unanticipated" and that the cause of securing "labor peace" justified the City paying the additional costs. Appendix A-72, at pp. 2-3.[21] The Mayor further asserted that the additional payments could be made without raising rates. *Id.* What is not clear from the documentation presented to the Investigator is when, and the extent

[20] In addition to the lack of any obligation to Norcal on the part of the City in light of the language of the 2002 Recycle Plus! Agreement, in 2001 City staff specifically concluded that the CWS employees falling within the Materials Recovery Facilities ("MRF") work classifications were not within the City's Prevailing Wage Policy for two independent reasons. First, as the employees already were subject to a collective bargaining agreement. Second, because the work performed at MRFs is off-site (i.e., not conducted on "publicly owned property."). As reflected in a September 17, 2001 Memorandum from Nina Grayson and Carl Mosher to the Mayor and City Council, with the subject "Prevailing Wage Issues," the work by CWS employees in the MRF classification "is not subject to prevailing wage." Appendix A-73, at p. 2. This point was discussed by the City Council in its September 20, 2001, Study Session (Appendix A-4, pp. 85-88) and at the September 25, 2001 City Council meeting. Appendix A-75, pp. 29-35.

[21] The September 16, 2004 Memorandum also states that it was only *after* approval by the City Council that the Mayor's office learned that the workers to be retained from Waste Management would be expected to change unions. In an October 14, 2004, Mercury News Editorial, Mr. Guerra is quoted as describing the statement as an "inconsistency" on the part of the Mayor, and that the sentence should have said "*before* council approval." Appendix A-76 at pp. 1-2. (Emphasis in original). What is not clear from Mr. Guerra's apparent correction to the Mayor's statement is whether the Mayor meant that payments were justified as he had made assurances to CWS, Norcal and the Teamsters to pay the labor cost differential (using additional payments by the City to Norcal as a pass through) in the "cause of securing labor peace."

to which, the City Council was advised by the Mayor (or through some other channel) that City staff had been working with Norcal for some time to provide such an amendment.

In addition to the Memorandum from the Mayor, Vice-Mayor Dando and Council Member Chavez, on September 16, 2004, Mr. Holgersson also submitted a memorandum to the City Council discussing the request from Norcal for an amendment to the 2002 Recycle Plus! Agreement. Appendix A-77. In the portion of the memorandum under "Analysis," Mr. Holgersson noted that "the Council is under no obligation to amend the contract with Norcal" and advised the City Council that "staff believes there are three primary alternatives for the City Council to consider with respect to the Norcal request: Amend the contract as requested; Provide Norcal with a counter proposal, and; Decline to amend the contract." *Id.*, p. 4. The only "recommendation" made was to "[a]ccept this report." *Id.*, at p. 1.

On September 20, 2004, City Council Members Reed and LeZotte submitted a Memorandum to the Mayor and City Council. Appendix A-78. The Council members recommended that the City Council reject the request from Norcal, citing the following reasons:

1. The proposed amendment appears to be a gift of public finds, which is prohibited by the California Constitution, since there is nothing in the Recycle Plus Agreement that provides for increased payment other than cost of living increases.

2. Any promises or representations that may have been made to Norcal were not disclosed to the Council when Norcal was approved as the preferred vendor. Nor were they disclosed to the Council before the contract with Norcal was approved. Therefore, they cannot be a part of the contract.

3. Any agreements made with Norcal without Council approval would be a violation of the Charter and void under California law.

4. Allowing a side deal to alter the terms of an agreement is not fair to the other companies who participated in the Recycle Plus RFP process but were not made aware of this arrangement.

5. … When the Council last considered and approved a rate increase, representations were made to the public that the approved rate increases would not be used for increased labor costs.

Id.

On September 21, 2004, the City Council passed a resolution authorizing the City Manager to negotiate an amendment to the 2002 Recycle Plus! Agreement to provide for the additional payments. Council Meeting Minutes at pp. 13-14 (Sept. 21, 2004; Appendix A-79). The motion was approved on a 7-3-1 vote, with City Council Members Cortese, LeZotte and Reed opposed, and Council Member Gregory absent. *Id.*, at pp. 13-14.

On December 10, 2004, Mr. Holgersson and Mr. Mosher submitted a Memorandum on the "Norcal Second Amendment" to the Mayor and City Council. Appendix A-80. This Memorandum recommends "[a]pproval of the Second Amendment to the Recycle Plus Integrated

Waste Management Services Agreement with Norcal…." *Id.*, at p. 1. While the Memorandum confirms verification by City staff of the documentation provided by Norcal to support its claim for reimbursement for additional wages and benefits, and verification that "Norcal has made payments to California Waste Solutions in accordance with their agreement regarding these additional labor costs" (*Id.*, at pp. 2-3), there is no indication of any effort by City staff to negotiate with Norcal an alternative or lesser amount.[22]

On December 14, 2004, the City and Norcal entered into the "Second Amendment to Agreement Between the City of San Jose and Norcal Waste Systems of San Jose, Inc. For Recycle Plus integrated Waste Management Services." Appendix A-81. As a part thereof, the City agreed to make additional payments to Norcal "…to compensate [Norcal] for additional labor costs paid by [Norcal] to its subcontractor, California Waste Solutions." *Id*., at pp. 2-3.

7. ISSUES CONSIDERED/ANALYSIS.

The Investigator has considered a number of factual and legal issues in connection with this matter. These issues, distilled from the Grand Jury Report, are set forth below and followed by the Investigator's preliminary analysis and conclusions.

A. Whether, prior to the October 10, 2000, vote by the City Council to award a 2002 Recycle Plus! Agreement to Norcal, Mayor Gonzales and/or other City staff knew that CWS would likely incur additional labor costs as a result of paying Teamster wages instead of Longshoreman wages.

B. Whether, prior to the October 10, 2000, vote by the City Council to award a 2002 Recycle Plus! Agreement to Norcal, Mayor Gonzales and/or other City staff assured Norcal and/or CWS that the City would pay the additional labor costs resulting from the payment of Teamster wages.

C. Whether, prior to the October 10, 2000, vote by the City Council to award a 2002 Recycle Plus! Agreement to Norcal, or thereafter, Mayor Gonzales or other City staff provided assurances to Norcal and/or CWS that he would take the steps necessary to see that the City paid the additional labor costs resulting from the payment of Teamster wages.

As an initial matter, the materials reviewed make it clear that the Mayor, his staff, and indeed the entire City Council were aware (or should have been aware) at the time of the October 10, 2000 vote that two unions held competing claims to represent CWS workers under the Norcal contract. The transcript of the City Council's meeting on October 10, 2000 includes statements by representatives of the Teamsters, the Longshoremen, as well as Norcal and CWS regarding this conflict. CMT, at pp. 26-35 (Oct. 10, 2000; Appendix A-36). Additionally, several City Council Members expressed concerns regarding the effect of the dispute on labor peace. *See id.* at pp. 20-

[22] From this Memorandum (and other materials presented to the Investigator) it does not appear that anyone at City staff asked Norcal for, or considered reviewing, internal Norcal documents to ascertain how Norcal calculated its original bid. Given one of the rationales presented in the Memorandum from the Mayor, Vice Mayor Dando and Council Member Chavez to the City Council was the assertion that "these labor costs were clearly unanticipated within the proposal that Norcal made to the City in 2000" (*see* Appendix A-72 at p. 2), a prudent consideration of the request from Norcal should have included a review of such materials, if any existed.

22, 25, 37.[23] Moreover, staff memos to the City Council from Mr. Mosher and Mr. Borgsdorf recommending approval of Norcal's proposal referenced the fact that CWS had a collective bargaining agreement with the Longshoremen and had not resolved the issue of the representation of its employees working on the Norcal subcontract. *See* Memo from Borgsdorf and Mosher to City Council Re: Selection of Contactors for Recycle Plus, (Sept. 22, 2000; Appendix A-21).

What is not apparent from the materials reviewed is which individuals knew that the labor "jurisdictional dispute" might lead to additional labor costs, when they knew it, and, whether any person or persons assured Norcal or CWS that the City of San Jose would provide reimbursement for such additional costs. Much of the discussion in the City Council concerning the dispute focused on the effect of the dispute on displaced workers, worker retention and labor peace, not wage disparities. *See* CMT, at pp. 11, 20-22, 24 (October 10, 2000; Appendix A-36). Neither the memos from City staff recommending the Norcal bid, nor the City Audit, reference cost implications resulting from the labor union dispute. Moreover, the Investigator was not provided with any transcripts, minutes or notes, interviews or sworn statements concerning any private meetings between any City representatives and Norcal, CWS or the unions prior to the October 10, 2000 vote. There also is an absence of e-mails from this time period that would be expected to exist in the normal course of events. The Investigator has been advised, however, that it is not the policy of the City to maintain historical e-mails as part of the "public records" and there are no back-up tapes that would have copies of e-mails from this time frame.[24]

Nonetheless, the materials reviewed as part of the investigation establish that Norcal and CWS did recognize, before the vote, that there were cost implications to the union dispute. Indeed, based on the Addendum they executed on October 9, 2000, Norcal and CWS clearly anticipated higher costs than were reflected in the bid from Norcal then pending before the City Council. *See* Addendum, Appendix A-33. The Mayor's position is that he did not appreciate the wage implications of the dispute until *after* October 10, 2000, and that even then the amount of the wage disparity was unclear. *See* Mayor's Response at p. 14 ("…"; Appendix A-26). For this

[23] In his October 30, 2000, Memorandum to the City Council "2002 Recycle Plus Follow-up Report On Rates and Services," Mr. Mosher stated (under the section addressing performance bonds), that "it is anticipated that emergency garbage and recycling services could be obtained immediately, and that a contract with a replacement hauler(s) could be implemented in less than a month." Appendix A-82 at p. 9. In his Memorandum dated March 7, 2001, to the City Council "Approval of 2002 Recycle Plus Agreements and Transition Update Report," Mr. Mosher confirms both that "Council approved labor provisions for prevailing wages and worker retention have been included to protect the interest of the employees providing services through the existing agreements" (*Id.*, at p. 3), and that Norcal of San Jose's parent company, Norcal Waste Systems, Inc. is providing a guarantee for Norcal's performance of the agreement." *Id.*, at p. 5.

[24] The City's 2001 document retention policy states that "correspondence," including "e-mail that is not considered transitory," are to be retained for a total of 2 years. It states that "e-mail is considered transient information and maintained for 90 days unless moved to a file or printed." The City's 2001 document retention policy states that "meetings" are to be retained for a total of 2 years. Note that the retention periods for "correspondence" and "meetings" are the same in the revised version of the policy, apparently effective in 2004. There are department-specific document retention policies as well, which have different retention periods. For example, the City Manager's policies call for retention for up to 5 years for "master files," and for "closure of issue plus 5 years" for "special issue files." It appears that the City Manager's policies provided to the Investigator were put into effect in April 2005, and it is not clear what department policy was for the City Manager or City Attorney pre-April 2005. The City Attorney's departmental policy calls for retention periods in the 2 years until no longer useful range for certain legal opinions. The City Auditor retains documents for significantly longer periods than the City Attorney and City Manager, with (non-permanent) total retention periods ranging in the 6-10 year range for most audits/files. Appendix A-83.

to be true, at least as to his knowledge of the existence of the wage differential, it must also be true that although the Mayor met with Norcal and possibly CWS during the time they were negotiating the Addendum (and in fact discussed the union dispute at least with Norcal during this time period), the wage disparity and/or cost implications of that dispute were not mentioned or otherwise discussed, even though it was a significant enough issue that Norcal and CWS executed the Addendum within three days of the October 6 meeting. The Mayor's denials notwithstanding, this position is not reasonably reconcilable with contemporaneous documents reviewed.

It is further unclear at this time based on the materials reviewed whether the Mayor's staff involved in the discussions with Norcal, including Mr. Guerra, could or would claim lack of knowledge of the potential wage differential prior to October 10, 2000, and of the alleged assurances given to Norcal regarding City reimbursement. Nonetheless, without interviewing the participants on all sides of any meetings and communications between City staff and Norcal, CWS and other relevant persons and entities, and obtaining any notes and other documents relating to these communications, it is not possible at this time to state with certainty a conclusion regarding the timing and full extent of the knowledge of the members of City staff as it relates to the additional labor costs and possible assurances of reimbursement.[25]

There is credible evidence in the reviewed materials, however, which strongly suggests possible assurances by "City officials" concerning payment by the City of the additional labor costs. Indeed, the timing and contents of the Norcal/CWS Second Amendment (which contemplates Norcal obtaining reimbursement from the City for the additional labor costs incurred by CWS), evidences an assurance from the Mayor or his staff that the City would reimburse Norcal *See* Second Amendment to Subcontract; Appendix A-81. Mr. Nicoletti of Norcal also linked Norcal and CWS' "commitments" to negotiate with the Teamsters and to pay higher wages and benefits with the City's amendment of the 2002 Recycle Plus! Agreement. *See* John Nicoletti letter to Del Borgsdorf re Recycle Plus! Program at pp. 1-2 (July 22, 2004; Appendix A-69).[26] Mr. Nicoletti further suggested that City staff "overseeing" Norcal's discussions with CWS (presumably before the October 10, 2000 vote, although it is not explicit as to timing) knew at least of the existence of a wage differential that would lead to additional labor costs, if not the precise amount. *See id.* As well, subsequent statements by Norcal representatives (although not under oath) suggest that Norcal and CWS believed that there was a pre-existing agreement with the City that if CWS agreed to allow Teamsters to represent its workers, the City would reimburse CWS for the additional costs. *See* CMT, at p. 49 (Dec. 14, 2004; Appendix A-84).

Additionally, correspondence between Mr. Guerra and Mr. Duong of CWS in February 2003 indicates the existence of an agreement or assurances of City payment of the additional labor costs. In this regard, Mr. Duong notes in the context of a threatened work stoppage that his ability to resolve the labor dispute "is contingent upon the resolution of the subsidy issue between Norcal and my company." Letter from David Duong to Joe Guerra (February 8, 2003; Appendix A-85). Mr. Duong then identifies the "terms" that he needs the City to "commit to in writing *based on the*

[25] The materials reviewed do demonstrate, however, that the Mayor knew of the existence of the potential dispute regarding additional labor costs well before execution of the 2002 Recycle Plus! Agreement with Norcal. *See*, e.g., Appendix A-37.

[26] Earlier drafts of this letter were apparently even more explicit in asserting a City "commitment" to pay the additional costs. *See supra*, at I.

agreement with your office," including that "[e]ither the City or Norcal will immediately reimburse CWS for the out-of-pocket differential labor costs incurred by CWS since July 1, 2002. The amount currently due CWS is approximately $750,000." *Id.* (emphasis added.) Mr. Duong further describes a special account the City is to establish for payment of the funds, which will amount to "$1.9 million for the contract year starting July 1, 2002 and shall increase by $250,000 each year thereafter—to $2.15 million for contract year two, and so on. *This is the amount that the City has agreed to pay*." *Id.* at pp. 1-2 (emphasis added). Mr. Duong made this statement more than eighteen months before the City Council agreed to amend the 2002 Recycle Plus! Agreement with Norcal and thus long before the City Council authorized the payment of these additional costs.

CWS was apparently under the further impression that the City of San Jose (and presumably the Environmental Services Department) could authorize the additional payments CWS and Norcal were seeking without City Council approval. *See* Letter from David Duong to Joe Guerra (Mar. 25, 2003; Appendix A-86). To wit, Mr. Duong complained to Mr. Guerra that CWS was "under the impression from the tone of our meetings that your payment to Norcal was assured as it would come from ESD and not require full Council approval." *Id.*

The Mayor himself has stated that he "told Norcal to request a contract amendment from the City and that he would recommend to Council its approval since these costs were clearly unanticipated within the proposal Norcal made in 2000." Memo from Mayor Gonzales *et. al.*, to City Council re Amendment to Norcal Agreement (Sept. 16, 2004; Appendix A-72). The Mayor apparently views this statement as innocuous. However, taking it at face value (and apart from the documentation, some of which is discussed herein, which belies this statement), it approaches the very thing of which the Mayor is accused, *viz*., assuring Norcal without the concurrence or knowledge of the City Council that he would take steps to ensure payment by the City of Norcal's additional labor costs. Even if such assurances were made well after the 2002 Recycle Plus! Agreement was awarded to Norcal, and even if the Mayor made clear to Norcal that his recommendation to the City Council was far from a commitment on behalf of the City of San Jose, unanswered are questions regarding why approval would be recommended by the Mayor when Norcal already had the contractual obligation to pay its subcontractors, and accepted the risk of changed conditions or such increased expenses when it voluntarily bid on and agreed to the terms contained within the 2002 Recycle Plus! Agreement.

Significant to the issues presented by the Grand Jury is the fact that the Mayor's staff pressed for an amendment to the 2002 Recycle Plus! Agreement despite the absence of a legal basis which would otherwise obligate the City to pay the additional labor costs. The original (and amended versions of the) 2002 Recycle Plus! Agreement contain provisions which explicitly state that Norcal is not entitled to payment adjustments for complying with prevailing wage requirements. *See* 2002 Recycle Plus! Agreement at §§17.02.3, 17.04, and 24.11 (Appendix A-43). Further, the 2002 Recycle Plus! Agreement contains an integration clause which provides that it is the entire agreement between the parties, thus negating any claim that an oral agreement or assurance could vary the terms of the contract. *See id.*, at §24.24. Finally, even assuming that a representative on behalf of the City "assured" Norcal that the City would provide reimbursement, such a promise was not enforceable for the further reason that it was made without authority of the City Council.

Nonetheless, the Mayor's staff persisted with efforts to obtain support for amending the Recycle Plus! Agreement to reimburse Norcal. Jim Holgersson noted Mr. Guerra's "strong desire to move a contract amendment forward for Norcal" but advised him that Norcal had not presented any "substantial justification" for the additional payments. E-mail from Jim Holgersson to Joe Guerra, copy to Del Borgsdorf, Richard Doyle, Carl Mosher and Lydia Tolles (May 26, 2004, 2:25 p.m.; Appendix A-63). Lydia Tolles, the Mayor's Budget and Policy Analyst, pressed repeatedly for action on the amendment, apparently asking Mr. Mosher at one point, "How fast can you get it through?" E-mail from Carl Mosher to Jim Holgersson and Susan Devencenzi (May 11, 2004, 8:51 a.m.; Appendix A-60).

These facts and inferences, while not sufficient to draw definitive conclusions regarding the Grand Jury's findings as to the knowledge of City staff regarding additional labor costs and alleged assurances of City reimbursement, constitute credible evidence for the conclusion that the Mayor and his staff engaged in the complained of conduct. Depending on the intentions of the City Council in light of the information set forth in this Report, a further investigation is warranted to determine whether there is any additional evidence to credibly suggest an alternative conclusion regarding who knew what and when regarding the additional labor costs and whether the Mayor and/or his staff inappropriately provided assurances that the City would provide payment for such costs. A further investigation would require interviews under oath of, *inter alia*, the Mayor, Mr. Guerra, and their relevant staff members. Additionally, the representatives of Norcal, CWS and the respective unions involved in discussions with City staff would need to be questioned under oath, and their documents regarding such meetings subpoenaed for review and analysis. Finally, an examination of the relevant pleadings, discovery and sworn statements generated in connection with the Teamsters' NLRB action against CWS, as well as documents relevant to the resolution and settlement of that matter, is necessary as these materials could be relevant or lead to relevant evidence regarding the issues that are the focus of this inquiry.

D. Whether Mayor Gonzales and Policy and Budget Director Joe Guerra concealed from the City Council the fact that Mayor Gonzales met with Norcal and CWS on October 6, 2000.

A public official in California owes a duty to the public. Although the case law has not precisely defined the extent of this duty, older case law indicates that public officers owe a duty similar to that of a trustee. *Woods v. Potter,* (1908) 8 Cal. App. 41, 44 ("Members of City Councils occupy a position of trust, and are bound to the same measure of good faith toward their constituents that a trustee is to his *cestui que* trust"); *Hobbs, Wall & Co. v. Moran,* (1930) 109 Cal. App. 316, 319 ("The theory of the law is that a councilman or other officer of a city sustains the same fiduciary relationship toward the citizens of his community that a trustee bears to his *cestui que* trust, and should therefore act with the utmost good faith"). In addition, the officer must discharge his duties with integrity and fidelity. *Terry v. Bender*, (1956) 143 Cal. App. 2d 198, 206. A recent case states the requirement as an obligation to exercise the powers conferred with disinterested skill, zeal and diligence, and primarily for the benefit of the public. *Clark v. Hermosa Beach*, (1996) 48 Cal. App. 4th 1152, 1170, *as modified on denial of reh'g*, (Sept. 11, 1996).

The courts have also discussed whether the duty of a public officer is a fiduciary duty, similar to the duty a director of a corporation owes its shareholders. *Nussbaum v. Weeks*, (1989) 214 Cal. App. 3d 1589, 1597-98. In *Nussbaum*, the defendant public official purchased land from the plaintiff seller, knowing that the irrigation policy would change and the land would become more valuable. *Id.* at 1592. The plaintiff seller alleged that the purchasing public official owed a fiduciary duty to the plaintiff, as a member of the general public, and therefore was required to disclose the change in water policy. *Id.* at 1594-95. The court, while rejecting this argument as it applied to the plaintiff seller in that case, stated: "If a public official violates the trust placed in him by privately profiting from information known to him in his public capacity, he has breached the duty he owes to his constituency, and he is therefore guilty of misconduct that can lead to his removal from office." *Id.* at 1598.[27]

As discussed herein, apart from whether the Mayor owes a duty to the public under the foregoing principles, the Mayor was required under the City's Independent Judgment Policy and Ethics Standards to disclose to the remaining members of the City Council all relevant facts regarding the Norcal relationship.[28]

It is not clear from the materials reviewed whether, and/or to what extent, the Mayor and Mr. Guerra "concealed" their October 6, 2000 meeting with Norcal from the City Council. Although the memos from City staff, City Council transcripts, and internal correspondence reviewed do not show affirmative disclosure of the meeting, this is not sufficient to conclude that it was necessarily concealed. Moreover, a mere meeting with Norcal by the Mayor and/or his

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[27] The *Nussbaum* opinion distinguished the duty to disclose that arises between a purchaser and a seller because that duty "usually springs from specific personal or business dealings." *Id.* "Because of such a relationship, a reasonable buyer would expect disclosure and the breach of that duty gives rise duty gives rise to the cause of action." *Id.* (citations omitted).

[28] In the Memorandum dated September 1, 2005, from the Mayor, Mr. Borgsdorf and Mr. Doyle (Appendix A-26), a reference is made to the provisions of City Charter Section 501, which provides as follows: "It is the intent of this Article that the Mayor shall be the political leader within the community by providing guidance and leadership to the Council, by expressing and explaining to the community the City's policies and programs and by assisting the Council in the informed, vigorous and effective exercise of its powers. Political leadership shall be concerned with the general development of the community and the general level of City services and activity programs." In discussing this Section in their joint Memorandum, the following was stated: "While the Grand Jury Report makes no mention of this section, it could be interpreted by the grand jury that the Mayor must provide all material information to the Council so as to assist the Council in making its decision. However, there is no specific requirement in the City Charter mandating the Mayor, or any Councilmember for that matter, advise the Council on all known matters." *Id.* at p. 11. While technically correct regarding the lack of any specific provisions of that nature in the City Charter, apart from the other grounds as discussed in this Memorandum and Report which give rise to the duty on behalf of the Mayor and his staff to disclose relevant information to the other members of the City Council, also important to note is the language of Section 502 of the City Charter, which provides in part: "Except as otherwise provided in this Charter, the Mayor shall possess only such authority over the City Manager and the administrative branch as he or she possesses *as one member of the Council*." (emphasis added). Consistent with the theme that the City Council, and not the Mayor, is the ultimate decision maker for the City of San Jose, are City Charter Sections 400 ("All powers of the City and the determinations of all matters of policy shall be vested in the Council, subject to the provisions of this charter and the Constitution of the United States"), 710 ("The City Manager shall be the chief administrative officer of the City…responsible to the Council for the administration of City affairs placed in his or her charge or under this Charter.") and 710(g) ("the City Manager shall…keep the Council fully advised as to the financial condition and future needs of the City….").

staff would likely not itself be problematic from a legal perspective[29], nor would the failure to disclose the meeting itself be improper absent a duty of disclosure by the Mayor or his staff. This situation must be contrasted with any commitments/agreements made during the meeting by the Mayor or his staff, purportedly on behalf of the City, for which the duty to disclose would exist under the legal standards herein described. Likewise, the duty exists to communicate to the City Council any material information that may have been obtained during this meeting, or otherwise, that bore upon Norcal's relationship with the City. Further, to the extent that there was an effort to conceal from the City Council any commitments or assurances provided by the Mayor or his staff to Norcal or CWS in connection with the meeting, particularly as a part of a larger cover-up, such an effort would run afoul of the City's Independent Judgment Policy, Ethics Standards and other laws including those described herein.

Further investigation is required to determine whether and to what extent there was a failure to disclose all relevant information arising in connection with the Mayor's October 6, 2000 meeting with Norcal and related communications as described in part herein. This effort would necessitate review of documents and notes relating to the meetings, as well as internal e-mails and correspondence among the Mayor and his staff, including Mr. Guerra. Additionally, questioning of the Mayor, Mr. Guerra and their staffs, at a minimum, would be required to fully examine this question.

E. Whether Mayor Gonzales and Policy and Budget Director Joe Guerra concealed from the City Council that Mayor Gonzales had assured Norcal and CWS that he would take steps necessary to have City pay additional labor costs.

As discussed above, there is circumstantial evidence of assurances by the Mayor and City staff beginning in October 2000 that the Mayor would take the necessary steps to secure City payment of Norcal's additional labor costs. The Mayor denies that he knew that Norcal would incur additional labor costs before the October 10, 2000 vote, but admits that upon learning of these costs he "told Norcal to request a contract amendment from the City and that he would recommend to Council its approval since these costs were clearly unanticipated within the proposal Norcal made in 2000." Memo from Mayor Gonzales *et. al.* to City Council re Amendment to Norcal Agreement (Sept. 16, 2004; Appendix A-72). What the Mayor admits doing is functionally indistinguishable from what the Grand Jury alleges he did, the critical

[29] *See* discussion regarding the Brown Act, Appendix B-5. In that respect, the issues raised by the Mayor in his Memorandum of September 20, 2005, questioning whether Council Member LeZotte or others met with Norcal representatives prior to October 10, 2000, and if so whether they "failed to notify" other members of the City Council of any such meeting (Appendix, A-7, at p. 3), misapprehends the nature of the concerns raised in the Grand Jury Report. There has never been any suggestion that Council Member LeZotte made any private promises or "assurances" to Norcal. Of course, should information be developed that indicates to the contrary, the principles discussed herein with respect to the Mayor and his staff would equally apply. In addition, as noted by the Mayor in Section 6 of his Memorandum of September 20, 2005, additional information regarding whether any City Council member met or spoke to any representative of Norcal, CWS, the Teamsters or the South Bay Central Labor Council in the three months prior to the rate increase hearings in the spring of 2003 could be relevant to the question whether the Mayor or his staff should have provided additional information known to them to the City Council before it voted on the 2004 Amendment. However, the foregoing information still does not address the apparent failure to provide appropriate notice to the public of all of the reasons for the 2003-04 rate increase, as discussed herein.

difference being the timing of this act, the scope and manner of the "assurances," and the extent to which the Mayor communicated the foregoing to his colleagues on the City Council.

Further investigation is required to determine more precisely the details regarding the predicate act, *i.e.*, when the assurances to Norcal where made, and secondly, if so, the extent to which the Mayor and/or his staff sought to conceal from the City Council that these assurances had been provided to Norcal. The reviewed materials, while constituting credible evidence to support the conclusion that the predicate act occurred, are not definitive as the timing and therefore additional investigation would be appropriate to determine whether (and, if so, to what extent and involving which individuals) there was an effort to conceal the predicate act from the City Council.

F. Whether Mayor Gonzales and/or Policy and Budget Director Joe Guerra concealed from the City Council that the additional labor costs were anticipated prior to the City Council vote on October 10, 2000. Conversely, whether Mayor Gonzales and/or Policy and Budget Director Joe Guerra thereafter misrepresented to the City Council and the public that the additional labor costs were unknown/unanticipated prior to the City Council vote on October 10, 2000.

The materials reviewed contain credible, if circumstantial, evidence that leads to the conclusion that the Mayor and/or Mr. Guerra knew or had reason to know before the October 10, 2000 vote that Norcal was likely to incur additional labor costs that were not reflected in Norcal's bid pending before the City Council. As discussed herein, Norcal and CWS understood before the vote that they would incur additional labor costs, as reflected in their Addendum executed one day before the vote, on October 9, 2000. *See* Addendum; Appendix A-33. Additionally, the Mayor and Mr. Guerra met with Norcal on October 6, 2000, and discussed the labor dispute. Statements by Norcal assert that "the Mayor's office" was overseeing discussions concerning the union dispute which directly concerned the wage differential and by extension, increased labor costs. *See* Nicoletti letter to Del Borgsdorf re Recycle Plus! Program at pp. 1-2 (July 22, 2004; Appendix A-69).

Given the apparent importance of the wage issue to Norcal and CWS, as evidenced by their October 9, 2000, Addendum, it would seem more likely than not that, the Mayor's denials notwithstanding, the wage differential would have been raised in the context of the discussions during the meeting on October 6, 2000. That the resolution of the labor dispute would lead to additional labor costs, even if the precise amount of such additional costs was uncertain, would have been patent. Nonetheless, it is undisputed that neither the Mayor or his staff, nor Norcal nor CWS, advised the City Council before the vote on October 10, 2000 that that Norcal's anticipated labor costs likely would be higher than the amount projected in Norcal's bid (even if the precise amount of increase was unknown), or that Norcal had already entered into an agreement with CWS that addressed this issue. *See* Addendum; Appendix A-33.

As stated above, these facts and inferences, while constituting credible evidence, are incomplete regarding the extent of the knowledge of City staff of the potential for additional labor costs, or the manner in which Norcal and CWS had agreed to address the situation, and whether the potential for such additional costs or related details were intentionally withheld from the City

Council. Thus, a further investigation is warranted to accurately determine who knew what and when, and the extent to which there was an effort to conceal known facts from the City Council.

G. Whether Mayor Gonzales and/or Policy and Budget Director Joe Guerra concealed from the City Council that the "primary purpose" of the 2003-04 rate increase was to cover additional labor costs for Norcal. Conversely, whether Mayor Gonzales and/or Policy and Budget Director Mr. Guerra misrepresented to the City Council and the public that the 2003-04 rate increase was needed for reasons other than to cover additional labor costs for Norcal.

The materials supplied to the Investigator demonstrate credible evidence that supports the findings of the Grand Jury that the Mayor and Mr. Guerra, and possibly other members of City staff, failed to clearly advise the City Council or the public of the "primary purpose" for the 2003-04 rate increase for the Recycle Plus! program. In particular, correspondence between Mr. Guerra and CWS representatives, as well as internal e-mails between Mr. Guerra and other members of City staff as noted herein, clearly demonstrates that Mr. Guerra, among others, understood that an undisclosed purpose of the 2003-04 rate increase was to fund the contemplated additional payments to Norcal for increased labor costs. As admitted by the Mayor in his September 1, 2005, Memorandum (Appendix A-26, pp. 12-13[30]), this purpose was not appropriately disclosed to the City Council or to the public. Instead, both the City Council and the public were told that the rate increases were necessary to bring the program closer to cost recovery and in response to "rising costs," and declining economic conditions. The facts supporting these findings are set forth below.

First, a number of e-mails and letters exchanged in February 2003, between Mr. Duong of CWS and Mr. Guerra in the context of a potential work stoppage at CWS, confirms the existence of an agreement (or, at a minimum, a commitment) by Mr. Guerra to have the City pay for the increased labor costs.

In a letter dated February 8, 2003, from CWS to Mr. Geurra, an agreement between CWS and the Mayor's office is referenced which sets forth, *inter alia*, the obligation to make specified payments to CWS. Appendix A-87. In a February 10, 2003, internal e-mail from Mr. Guerra to Mr. Mosher, Mr. Doyle and Mr. Borgsdorf (and which attaches the February 8, 2003, letter from CWS), Mr. Geurra confirms that material portions of the CWS letter accurately reflect commitments made by Mr. Guerra on behalf of the City. Appendix A-88. In response, Mr. Mosher raises the point that "We can not immediately reimburse either Norcal or their subcontractor CWS. The must first be amended [sic]." Appendix A-89. In a separate communication later that same day, Mr. Geurra then advised Mr. Duong that "[o]ur office intends to bring to the Council a rate increase that would include approximately $.95, subject to legal review and Council approval-these funds would be available to offset unanticipated labor costs under Norcal's contract with the City." E-mail from Guerra to David Duong (February 10, 2003, 3:34:36 p.m.; Appendix A-90). Mr. Duong complained in response that he was "under the impression from the tone of our meetings that *your payment to Norcal was assured as it would come from ESD and not require full Council approval*." E-mail from David Duong to Joe Guerra

[30] As described by the Mayor: "It would have been better if the City Council was informed that these anticipated costs were included in the rate increase." *Id.*

(February 10, 2003, 6:46:39 p.m.; Appendix A-91) (emphasis added).[31] Mr. Guerra's response suggests that he also was operating under the belief that the necessary item for approval by the City Council was limited to the rate increase, upon which "…these finds would be available to offset unanticipated labor costs under Norcal's contract with the City." E-mail from Joe Guerra to David Duong, and copied to the City Attorney, City Manager, and others, dated February 10, 2003. Appendix A-92.

E-mail exchanges among City staff in the February 2003 time-frame indicate that other members of City staff were aware that Mr. Guerra intended to seek a rate increase for the purpose of funding additional payments to Norcal, even as they question the appropriateness of such increases. For example, Mr. Borgsdorf comments that: "I do not think anyone but Joe [Guerra] has tied the rate increase to Norcal and their subcontractor." E-mail from Del Borgsdorf to Larry Linsbee, Carl Mosher, with copy to Rita McGrath (February 11, 2003, 7:22 a.m.; Appendix A-93). Mr. Borgsdorf further asks: "What would be the actual increase necessary to achieve both objectives? Has Rick [Doyle] talked to Joe about the appropriateness of these negotiations and the City's authority to 'reach through' the Norcal contract?" *Id.* Documentation supplied to the Investigator does not reflect either an appropriate response to these questions, or any follow-up to what was clearly a significant financial issue. Instead, as reflected in the reviewed materials, one week later (by February 18, 2003) Mr. Borgsdorf had resolved any doubts about using the rate increases to fund additional payments to Norcal, and had received the Mayor's approval to move forward with the plan. In this regard, in a chain of e-mails dated February 18, 2003, Mr. Borgsdorf advises Mr. Mosher that:

> I had a discussion with the Mayor and his staff this a.m. They understand that the rate increases necessary for Recycle Plus will be higher than previously anticipated since we will be working on both the "labor peace" issues as well as cost recovery. Our assignment is to craft a multi-year rate increase that gets us moving forward on these two objectives. Do we need Council action to begin the process? Del

E-mail from Del Borgsdorf to Mosher; Appendix A-94. Mr. Mosher responds that "I think in order to pay Norcal/CWS for 'labor peace' we need an amendment to Norcal's contract" which will require "Council action." E-mail from Mosher to Del Borgsdorf, Larry Linsbee and Richard Doyle (February 18, 2003, 2:54 p.m.; Appendix A-95). Mr. Mosher nonetheless states that "[w]e are working on multi-rate alternatives now. … We will now plug in the 'labor peace' number." *Id.* Once again, while some members of City staff questioned the rationale, there is a troubling absence of challenges from key decision-makers as to the appropriateness of increasing rates for "labor peace" given the existing contractual commitments by Norcal.

Staff memoranda to the City Council regarding a proposed rate increase for the Recycle Plus! program for 2003-04 did not specifically mention additional labor costs to CWS or Norcal as a basis for the rate increase. In fact, on February 25, 2003, just two weeks after the e-mail

[31] In a subsequent letter, Mr. Duong reiterated his understanding of the commitment by Mr. Guerra, and inquired regarding the "timing of our bringing to the City Council the residential refuse Rate increase necessary to cover the $1.9 million in labor rate subsidy you agreed the City would be responsible for." Letter from David Duong to Joe Guerra (Mar. 25, 2003; Appendix A-86; (emphasis added). Mr. Duong further stated that "Bob Morales at Teamsters Local 350 is anxious to know when I will be able to execute an agreement with him that codifies what you, he and I agreed to last month contingent upon the city's subsidy." *Id*. (emphasis added).

exchange in which Mr. Guerra states his intention to support a rate increase that would provide funds for paying Norcal, Mr. Mosher circulated a memo to the City Council recommending that the City Council "expedite" steps necessary to raise service rates. Memo from Mosher to Honorable Mayor and City Council re Recycle Plus! Rate Increase (Feb. 25, 2003; Appendix A-96). Mr. Mosher stated that the reasons for the rate increase were a "downturn in the local economy" which had led to decreased waste generation and declining revenue to the Integrated Waste Management ("IWM") fund. *Id.* at p. 2.

The notices subsequently issued to the public regarding the proposed rate increase similarly failed to advise the public that the rate increase was designed at least in part to fund additional payments to Norcal for labor costs. Notice of Public Hearing: Proposed Recycle Plus! Service Rate Increases (April 11, 2003; Appendix A-97). Instead, the notice states that the proposed 9% rate increase "is needed to help make garbage and recycling services more self-supporting, minimize the amount of taxpayer funds required to support them, and cover rising costs since rates were last increased." *Id.* To the extent that the additional labor costs could be arguably included under the rubric of "rising costs" as stated in this notice, the staff memoranda to the City Council, which purports to explain in detail the bases for the rate increases and the cost implications, includes no mention of additional labor costs associated with the Norcal agreement. *See* Memorandum dated April 28, 2004, from Mosher to Honorable Mayor and City Council re Adoption of Resolutions Revising Recycle Plus Rates (Appendix A-98); Memorandum dated May 8, 2003 from Carl Mosher to Honorable Mayor and City Council re Public Hearing on Recycle Plus! Rate Increases and Adoption of Resolutions Revising Recycle Plus! Rates and Commercial Franchise Fees and AB939 Fees Effective July 1, 2003 (Appendix A-99). Thus, the materials supplied to the Investigator make it clear that the public was not informed of the full, true reasons for the rate increase.

Internal e-mails among Mr. Guerra and City officials a year later further confirm that City staff knew at the time of the events in question that the stated reasons given to the City Council and the public were not the real reasons for the 2003-04 rate increase. As previously noted, on May 26, 2004, in the context of discussing the proposed second amendment to the City's agreement with Norcal, Mr. Guerra states unequivocally that: "[a]s I have pointed out to Rick [Doyle] and Del [Borgsdorf] by phone today, *we raised our customers' rates already to specifically cover this additional cost.* I believe I even still have the spread sheet Carl [Mosher] made up which showed the justification for the rate amount that was settled on." E-mail from Joe Guerra to Richard Doyle, Jim Holgersson, Del Borgsdorf and Carl Mosher (May 26, 2004, 3:44 p.m.; Appendix A-100) (emphasis added). Mr. Guerra goes on to say that: "[i]t is disingenuous at best to now be questioning amending the contract. I'm terribly uneasy with us continuing to charge customers and keeping the money. We either need to process this amendment sometime soon or refund the money to customers and lower their rates. I'd really like us to agree on a timeline when either the Administration or our office will bring one of those options to the Council for approval." *Id.*

The exchange which follows Mr. Guerra's e-mail is further revealing. As previously mentioned, Mr. Doyle responds that, among other things, "[a]s I remember, the Council did not raise rates to cover any specific additional costs, and there was nothing in the staff memo that mentioned this issue. Council's action was to make the Recycle Plus! program closer to cost

recovery (which apparently is still only at 91%)." E-mail from Richard Doyle to Joe Guerra, Jim Holgersson, Del Borgsdorf and Carl Mosher (May 27, 2004, 8:59 a.m.; Appendix A-101). Mr. Guerra states in response that: *"you are correct that there was nothing in the memo to the council, however several staff were aware of the $1.9 million number that was folded into the rates."* E-mail from Joe Guerra to Richard Doyle, Jim Holgersson, Del Borgsdorf and Carl Mosher (May 27, 2004, 9:19 a.m.; Appendix A-102) (emphasis added).

Based on the foregoing e-mails, there is substantial, credible evidence to support the conclusion that the 2003-04 rate increase was designed at least in part to fund additional payments to Norcal for labor costs, and that this information was not appropriately disclosed to the City Council or the public. This was not the stated reason for the increase that was provided to the City Council, nor was it the reason specified in published notices to the public of the rate increase. Moreover, the true purpose for this rate increase required City Council approval, which approval did not come until much later, in September 2004.

The materials reviewed thus demonstrate that the Mayor, Mr. Guerra and/or other City staff made commitments to Norcal and/or CWS to obtain funding for the additional payments long before the City Council had agreed to do so. Whether such a commitment was made before the City Council awarded the Recycle Plus! contract to Norcal in October 2000, or in the context of the February 2003 labor dispute, or at another time, does not change the obligation to have provided a complete and honest analysis to the City Council and the public prior to the vote on the rate increase. Mr. Guerra's statement that Mr. Mosher developed a spreadsheet analysis which correlated the additional payments with a concomitant rate increase is corroborated by Mr. Mosher's own February 2003 e-mail in which he states that he will "plug in" the "labor peace number" to the rate increase models he was developing. These facts should be further investigated through interviews with Mr. Guerra, Mr. Mosher and Mr. Borgsdorf, their respective staffs, as well as through subpoenas of all documents, including correspondence and any spreadsheets or drafts, which relate to this matter.

The Mayor's personal involvement in and/or knowledge of the foregoing activities cannot be definitively established without further investigation. The materials reviewed, such as Mr. Borgsdorf's e-mailed comments to Mr. Mosher, confirm that the Mayor knew of, and approved, incorporating the additional payments to Norcal in the 2003-04 rate increase, and directed City staff to develop a multi-rate increase model that would fund the payments, among other things. However, further investigation is necessary to fully and accurately determine the extent (if any) of the Mayor's knowledge and involvement, including interviews of the Mayor, his staff, and review of all documents, including notes and internal correspondence, which relate to the rate increase.

H. Whether Mayor Gonzales and/or Policy and Budget Director Joe Guerra misrepresented to the City Council and the public that there would be no rate increases as a result of the City Council's decision to pay Norcal the additional $11.25 million.

The Mayor represented to the City Council that the payment by the City of San Jose of the additional labor costs to Norcal would not result in a rate increase. Specifically, in a memo to the City Council in which he recommends that the City Council agree to amend the City's agreement with Norcal to provide for additional payments, the Mayor states that "[t]he higher costs will not

increase rates for our residents. . ." Memo from Mayor Gonzales, Vice-Mayor Dando and Councilmember Chavez re Amendment to the Agreement with Norcal for Recycle Plus Services, at p. 3 (Sept. 6, 2004; Appendix A-72). This statement is consistent with the position taken by the Deputy City Manager, Jim Holgersson. In this regard, during the course of the City Council discussions regarding amending the City/Norcal agreement, Vice-Mayor Dando specifically asked how rates would be affected by the proposed additional payments to Norcal. CMT, at p. 19 (Sept. 21, 2004; Appendix A-79). Mr. Holgersson responded that: "[t]he actual rates we have in place today will pay for this amendment." *Id.* These statements, while technically true, were materially misleading for the reasons discussed herein.[32]

To the extent that the Mayor and other City staff knew that the existing rate structure would cover the additional payments because the prior 2003-04 rate increase was specifically designed for that purpose -- and thus rates had *already* been increased to make payments to Norcal -- the Mayor's statement and Mr. Holgersson's response, and the failure of others with knowledge to disclose the reason for the earlier rate increase, are misleading. Indeed, stating prospectively that rates would not need to be raised in the future, when they had in fact already been raised for this contingency without appropriate disclosure of that fact, is sophistic and disingenuous.

As indicated elsewhere in this Report, the materials reviewed reflect that Mr. Guerra, Mr. Borgsdorf, Mr. Mosher and the Mayor himself, as well as Mr. Holgersson and others privy to the internal e-mails discussed in this report, were either directly involved in or had contemporaneous knowledge of an effort to design the 2003-04 rate increase to generate funds for additional payments to Norcal. That the documentation and records of City Council discussions provided to the Investigator concerning the amendment to the Norcal agreement were devoid of any indication that the past rate increase was at least in part for the purpose of paying Norcal, and that the Mayor and other officials indicated that a (future) rate increase would not be necessary to cover the payments, constitutes credible evidence to support the conclusion of an on-going failure to provide all relevant information to the City Council or the public.

The duty requiring disclosure of material facts arises when a fiduciary or principal-agent relationship exists. *See, e.g., Black v. Shearson, Hammill & Co.,* (1968) 266 Cal. App. 2d 362, 367-68 (fiduciary relationship exists between stockbroker and his customers); *St. James Armenian Church of L.A. v. Kurkjian,* (1975) 47 Cal. App. 3d 547, 551 (duty to disclose arises in principal agent-relationship). In these situations, suppression or concealment of a material fact by a fiduciary constitutes actionable fraud. *Moe v. Transamerica Title Ins. Co.*, (1971) 21 Cal. App. 3d 289, 306. As discussed elsewhere in this Report, a public official owes a duty to the public and an obligation to disclose material facts to the City Council when negotiating a public contract.[33]

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[32] It does not appear from the materials provided that Vice-Mayor Dando or Councilmember Chavez were aware of the situation involving the prior rate increase. Indeed, the question posed by Vice-Mayor Dando further supports the conclusion that the City Council (other than the Mayor) was not informed of the true reason for the prior rate increase.

[33] The civil wrong (tort) of fraud, technically labeled deceit under California law, requires a showing of: 1) a false representation or concealment of material fact; 2) made without knowledge of its falsity or without a reasonable basis to believe that it is true; 3) with the intent to induce the person to whom it is made to act on it; 4) an act by that person in justifiable reliance of the act or omission; and 5) to that person's damage. *South Tahoe Gas Co. v. Hofmann Land Improvement Co.*, (1972) 25 Cal. App. 3d 750, 765. A duty to disclose material facts arises when:

While at this point in the investigation credible evidence exists from which one could conclude that the statements were made with the intent that the City Council rely upon them, it is unclear whether the City Council justifiably relied upon the Mayor's statements in light of their knowledge and experience. *See Gray v. Don Miller & Assocs., Inc.*, (1984) 35 Cal. 3d 498, 503 (justifiable reliance is a subjective test). Further investigation is necessary to fully and accurately determine the knowledge of the Mayor, Mr. Guerra and other City staff as it relates to the statements made regarding rate increases. Another area of inquiry that would be appropriate relates to the extent to which any of the City Council members understood, when voting on the 2003-04 rate increase, that it was intended in part to cover additional payment to Norcal. At this juncture, however, there is sufficient credible evidence in the materials reviewed to support the finding of the Grand Jury as to this element of the alleged activity.

I. Whether Mayor Gonzales and/or Policy and Budget Director Joe Guerra concealed from the City Council, until September 2004 that the threatened Teamster's strike was "primarily caused" by Mayor Gonzales' delay in seeking City Council approval for the additional $11.25 million payment to Norcal.

At the outset, it should be stated that determining the "primary" cause for the threatened Teamster's work action in February 2003 is beyond the scope of this stage of the investigation. To the extent that the "primary" cause for the threatened strike can be accurately determined, such an inquiry would require interviews with the principals at the Teamster's union as well as with CWS and Norcal representatives. Additionally, documents relating to the threatened action, whether in the possession of the union or CWS, would need to be reviewed.

Notwithstanding the above qualifications, the reviewed materials provide a link between the threatened work action and, among other factors, the additional payments sought by Norcal and CWS from the City of San Jose. The materials include correspondence between Mr. Duong of CWS and Mr. Guerra concerning the threatened action and the efforts by CWS and City officials to defuse it. This correspondence indicates that the City's non-payment of the additional labor costs was a factor influencing CWS' actions in its negotiations to resolve the dispute with the Teamsters.

In a letter dated February 8, 2003, from Mr. Duong to Mr. Guerra, Mr. Duong lists proposed terms of an agreement between CWS and the Teamsters. *See* Letter from David Duong to Joe Guerra (February 8, 2003; Appendix A-87). Mr. Duong notes that his "ability to execute

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1) the speaking party owes a duty to the other party; or 2) when the speaking party gives information of other facts that are likely to mislead for want of communication of the suppressed fact. Cal. Civ. Code § 1710(3). Thus, a misrepresentation can occur when a party makes statements that is likely to mislead for want of communication of the unstated fact. *Id.* In this regard, a person cannot suppress or conceal facts within his knowledge that materially qualify his or her other statements because one who speaks at all must make a full and fair disclosure. *Brownlee v. Vang*, (1965) 235 Cal. App. 2d 465, 477.

The related doctrine of constructive fraud may also be applicable to the Norcal transactions. Constructive fraud occurs when a party breaches a duty by which a person, without a fraudulent intent, gains an advantage by misleading another to his or her prejudice. Cal. Civ. Code § 1573 (1). If there is a duty to speak because of a fiduciary, trust, or confidential relationship, a failure to disclose is considered constructive fraud. *See, e.g., Montoya v. McLeod*, (1985) 176 Cal. App. 3d 57, 64. There is a presumption of fraud and the burden is on the party who obtained an advantage to show fairness and good faith in all respects when a fiduciary relationship, legal or equitable duty, or trust exists between the parties. *Boyd v. Bevilacqua*, (1966) 247 Cal. App. 2d 272, 290-91.

this agreement is contingent upon the resolution of the subsidy issue between Norcal and my company." *Id.* Mr. Duong then identifies the "terms" that he needs the City to "commit to in writing based on the agreement with your office," including that "[e]ither the City or Norcal will immediately reimburse CWS for the out-of-pocket differential labor costs incurred by CWS since July 1, 2002. The amount currently due CWS is approximately $750,000." *Id.* Mr. Duong further describes a special account the City is to establish for payment of the funds, which will amount to "$1.9 million for the contract year starting July 1, 2002 and shall increase by $250,000 each year thereafter—to $2.15 million for contract year two, and so on. *This is the amount that the City has agreed to pay.*" *Id.* at pp. 1-2 (emphasis added).

Subsequently, as noted elsewhere, Mr. Guerra advised Mr. Duong that he would be seeking a rate increase to cover the proposed additional payments, a process which he estimated could take four months. E-mail from Joe Guerra to David Duong, copy to Richard Doyle, Carl Mosher, Del Borgsdorf and Rebecca Dishotsky (Feb. 10, 2003, 3:34:36 p.m.; Appendix A-90) Mr. Duong expressed his displeasure with this time-table and noted that he was "under the impression from the tone of our meetings that your payment to Norcal was assured as it would come from ESD and not require full Council approval." E-mail from David Duong to Joe Guerra (February 10, 2003, 6:46:39 p.m.; Appendix A-91). Mr. Duong noted that "the City's position will not allow me to sign the labor agreement" due to, *inter alia*, the economic burden associated with CWS continuing to absorb the additional labor costs without reimbursement from Norcal or the City. *Id.*

On February 19, 2003, Mr. Mosher reported to Mr. Borgsdorf that the Teamsters had notified Norcal and CWS that they would strike. E-mail from Carl Mosher to Del Borgsdorf, copy to Mark Linder, Jim Holgersson, Tom Manheim, Lindsey Wolf (February 19, 2003, 4:12:57 p.m.; Appendix A-104) Mr. Mosher stated that "Norcal also believes that the Teamsters took this action because they are not pleased with how long it will take for the money to be paid from the City to Norcal/CWS." *Id.* While there are several internal City documents that reflect the understanding of City staff that the City had no legal obligation to make any additional payments to Norcal, and that Norcal had the continuing obligation to pay CWS for the labor costs incurred, absent from the materials reviewed is an indication that anyone on behalf of the City addressed with Norcal its legal and contractual obligations *to* the City, or the impact on those obligations should Norcal fail to timely pay the amounts due CWS.

The foregoing materials demonstrate a connection between the threatened labor action in February 2003 and the contemplated payment by the City of a "subsidy" for the additional labor costs sought by Norcal/CWS. In addition, as stated elsewhere, the reviewed materials indicate possible assurances by City staff of City payment of these costs, and at least of a commitment to seek them from the City Council, although precisely when such assurances were made and by whom is not yet definitively clear. Whether the City's failure to pay these costs was in fact the primary factor in the threatened action requires further investigation.

In addition, while the Mayor has stated to the City Council that the City's payment of these costs was necessary to ensure "labor peace," the Mayor has not stated that his "delay" in seeking City Council approval for the payments to Norcal was a factor in causing the threatened

strike. Accordingly, further investigation is required to determine whether the City's delay in paying the additional labor costs was the primary reason for the labor problem.

J. Whether Mayor Gonzales and/or Policy and Budget Director Joe Guerra failed to disclose to the City Council and the public that Norcal "may be willing" to accept less than the $11.25 million it requested.

To answer this question, further investigation into the discussions between City staff and Norcal concerning the 2004 Amendment is necessary to determine the dynamics of the negotiations and indeed, whether any negotiations regarding the amount of payments actually took place. However, several comments are appropriate based on the Investigator's review of the materials provided.

First, it is clear that the City Council authorized the City Manager to negotiate an amendment to the 2002 Recycle Plus! Agreement for the purpose of addressing the additional payments sought by Norcal. (CMT, at p. 24 (Sept. 21, 2004; Appendix A-79). Despite this authority, it is not clear that the City Manager actually negotiated with Norcal to address this issue from the standpoint of whether the City should pay *any* amount, much less the $11.25 million being requested. The fact that the 2004 Amendment ultimately presented to the City Council for approval provided for the City to pay Norcal essentially the same amount that Norcal initially requested suggests that there was no negotiation as to the amount paid, or if there was, that for some reason the City was unable to extract any concessions from Norcal (apart from the "consideration" provided for the 2004 Amendment, with a value in the range of approximately $100,000 to $150,000). Given that the City had no legal obligation to make the payments, it seems odd that the City would be so without leverage that it would be unable to negotiate the amount sought to some lesser amount. Accordingly, there is a question regarding whether City staff complied with the resolution of the City Council, and if not, why not. A possible explanation for the lack of negotiation is that City staff and Norcal believed that a "deal" had already been struck before the City Council acted. While there could be a more benign explanation, further investigation is warranted to scrutinize the "negotiations" to address this issue.

Second, the reviewed materials indicate significant cooperation between Norcal and City staff regarding Norcal's request for an amendment to the 2002 Recycle Plus! Agreement. Specifically, in August 2003, Norcal provided Mr. Mosher with a draft of its request for amendment. E-mail from John Nicoletti to Carl Mosher (August 11, 2003, 8:29 a.m.; Appendix A-105) Mr. Mosher then circulated the draft internally and solicited comments from other members of City staff. E-mail from Carl Mosher to Jim Holgersson, Steve Willis, and Elaine Leung (August 11, 2003, 9:12 a.m.; Appendix A-106).

City staff then provided extensive comments regarding Norcal's draft. Elaine Leung suggested that language in Norcal's draft letter be modified because it left the impression that there was already a deal between the City and Norcal for the additional payments. E-mail from Elaine Leung to Carl Mosher, copy to Steve Willis (August 11, 2003, 3:36 p.m.; Appendix A-107). In this regard, Ms. Leung stated that: "I would suggest that Norcal present this as a stand-alone proposal without the reference to previous agreements and assertions … As currently written, it appears as if a deal was already made. This letter basically portrays the amendment as a formality to an arrangement that was made by certain 'City representatives.' This will strike a bad

chord with other Council members." Ms. Leung commented further that the positions of "City Representatives" as described in Norcal's letter were not consistent with City policy. *Id.* In a telling example, Ms. Leung identified the following statement in Norcal's draft letter: "[I]n return, the City representatives assured Norcal and CWS that CWS would be reimbursed for the additional labor costs that would be required to retain the existing workers and their collective bargaining representative." *Id.* Ms. Leung noted that "the City does not support one union over another" and also seems to refer to this passage when she suggested that the letter suggested a deal "was already made." *Id.*

In light of Ms. Leung's comments, Norcal sanitized its written request for an amendment to the 2002 Recycle Plus! Agreement to avoid the impression of a pre-existing deal. *See* Nicoletti letter to Borgsdorf (July 22, 2004; Appendix A-69). Tellingly, the letter that Norcal sent as its official request for amendment does not state, as did the original draft, that "City Representatives assured Norcal and CWS that CWS would be reimbursed."

What is further perplexing is why City staff would be aiding a private party in this fashion in its efforts to obtain money from the City, rather than solely advancing the interests of the City at large. While this conduct was not included in the Grand Jury's findings, credible arguments exist to support the conclusion that it may violate the Independent Judgment Policy, in spirit if not in letter, as well as other legal obligations as discussed herein. Moreover, to the extent that the apparent collusion between City staff and Norcal extended to prevent true arms-length negotiations between the City and Norcal, as mandated by the City Council, this would present a serious, broad-based scheme to violate (or, at a minimum, simply ignore) the role, and resolution, of the City Council.

K. Whether Norcal concealed and/or failed to disclose to the City Council the October 9, 2000 addendum to its contract with CWS.

The materials reviewed do not indicate that Norcal provided any formal notification to the City Council of the October 9, 2000, Addendum entered into between Norcal and CWS prior to execution of the 2002 Recycle Plus! Agreement. However, at the time that Norcal entered into the Addendum, it did not yet have a contract with the City and, indeed, had not yet been awarded the contract. It is possible that in 2000 Norcal contemporaneously (or later) notified City staff, other than the Mayor and his staff, such as Mr. Guerra, of its Addendum. However, the documents reviewed as a part of this investigation make it clear that, at a minimum, the Mayor and his staff knew of the Addendum in October 2000.

In its October 18, 2000, letter to the Mayor (Appendix A-37), the Teamsters specifically advise the Mayor of the existence of "…two contracts that have been talked about but not disclosed. One is the ILWU contract with CWS, *and the other is the contract between Norcal and CWS*. Your office should insist that copies of both contracts be submitted to the City, so that your staff and Council members will have full knowledge of all agreements that bear on compliance with City policies." *Id.* (emphasis added). However, the documents submitted to the Investigator do not reflect that any action was taken by the Mayor in response to this pointed suggestion. Given the Mayor and his staff's involvement with Norcal's discussions with CWS, it is reasonable to infer that some members of the Mayor's staff, and City staff, learned of the Addendum long

before October 7, 2004.[34] Given the nature of the commitments by Norcal in the Addendum, it is hard to conceive of any explanation that would justify withholding the Addendum from the City Council.

Regardless of whether certain City staff had knowledge of the Addendum, the critical legal issue is whether Norcal had a duty to disclose the existence of the Addendum to the City Council. If Norcal had an obligation to disclose the Addendum to the City Council, it must be derived from either its agreement with the City, or via statute or other legal authority or doctrine.

Norcal's Addendum with CWS does not conflict on this point with Norcal's obligations under the 2002 Recycle Plus! Agreement. The 2002 Recycle Plus! Agreement includes a provision which provides, in pertinent part, that: "[Norcal] shall be responsible for directing the work of [Norcal's] subcontractors and any compensation due or payable to [Norcal's] subcontractors shall be the sole responsibility of [Norcal]." 2002 Recycle Plus! Agreement, §24.11; Appendix A-43. The Addendum provides that "Norcal desires that CWS agree to the wage and benefit package required by the City of San Jose and is willing to reimburse to CWS any difference in cost. CWS is willing to agree to a higher wage and benefit package cost provided that Norcal reimburses CWS for the difference in cost." *See* Addendum. Thus, the Addendum is consistent with Norcal's agreement with the City in that under either agreement, Norcal is solely responsible for payments to its subcontractor, CWS.

While there are no provisions in the 2002 Recycle Plus! Agreement which would appear to require Norcal to disclose to the City its Addendum with CWS, the legal principles involving misrepresentations and omissions discussed above with respect to the obligations of the Mayor and City staff are equally applicable with respect to an analysis whether Norcal was obligated to disclose to the City the fact that it had entered into the Addendum.

L. Whether political contributions by Norcal, CWS, or the Teamsters improperly influenced the Mayor, Policy and Budget Director Guerra, staff or Council members with regard to the approval of the payment of the entire $11.25 million to Norcal via the amendment to the City's contract with Norcal.

The materials reviewed reflect contributions made by a number of interested parties to the Mayor, among others. These materials do not, by themselves, demonstrate that the contributions were the causal factor (in the manner of a *quid pro quo*) in influencing the City's decision to enter into the 2004 Amendment.

[34] As reflected in an exchange of e-mails in September 2004 between Council Member Reed, Mr. Doyle and others, Mr. Reed did not appear to have been aware of the Addendum prior to seeing a reference thereto in the Second Amendment to Subcontract between Norcal and CWS. Mr. Willis confirmed that a copy of the document was not in the City files. Appendix A-108. A copy was finally obtained and apparently was provided to Mr. Reed on October 7, 2004. Appendix A-109. Mr. Reed, along with Council Members Cortese and LeZotte voted against the 2004 Amendment. CMT, at 9. 51 (Dec. 19, 2004) Appendix A-110.

M. Whether the City's agreement to pay the additional payments to Norcal is void or unenforceable and/or constitutes an illegal gift of public funds.

The Grand Jury recommended that the "City Attorney or the special investigator should take legal steps necessary to rescind the $11.25 million Norcal/CWS reimbursement." Grand Jury Report, p. 2. While it is beyond the scope of this investigation to take steps to "rescind the…reimbursement," applicable legal principles are noted herein.

In California, cities are either charter cities or general law cities. Cal. Gov't Code § 34100 *et seq.* In charter cities, such as the City, the city charter governs over general state law regarding the city's legislation of municipal affairs. *See, e.g., R & A Vending Serv., Inc. v. L. A.,* (1985) 172 Cal. App. 3d 1188, 1191 ("state general law bidding procedures do not bind chartered cities where the subject matter of the bid constitutes a municipal affair"); *Sonoma County Org. of Public Employees v. County of Sonoma,* (1979) 23 Cal. 3d 296, 316 (if chartered city legislates with regard to municipal affairs the charter prevails over general state law). City public utilities and city sewage have been held to be municipal affairs. *See Smith v. Riverside,* (1973) 34 Cal. App. 3d 529, 534 (city operated public utilities); *Santa Clara v. Von Raesfeld*, (1970) 3 Cal. 3d 239, 246 (city sewage). In general, contracts with public entities in California are not subject to any special rules of interpretation or effect of the contracts. *See M.F. Kemper Constr. Co. v. L.A.*, (1951) 37 Cal. 2d 696, 704. A charter city's ability to contract is controlled by the terms of its charter. *First Street Plaza Partners v. L. A.*, (1998) 65 Cal. App. 4th 650, 661. Therefore, any act in violation of the city's charter is vo*id. Id.* at p. 664 (citing *Domar Electric, Inc. v. Los Angeles*, (1994) 9 Cal 4th , 161, 171).

In San Jose, the power to contract with "private agencies" is granted to the City Attorney pursuant to Section 800 of the San Jose City Charter. In addition, Charter Section 1301 provides the City Council with authority to grant by ordinance a franchise to corporations to furnish the City and its inhabitants with public utilities and services. Contracts for residential solid waste disposal appear to be governed by Section 800. *Compare* Mun. Code § 9.10.1000 (B) ("the City, in the City's sole discretion, may enter into one or more agreements for residential solid waste collection services") *with* Mun. Code § 9.10.1600 (stating that contracts for disposal of *commercial* waste are governed by the franchise provisions in section 1301 *et seq.*). In addition to the City Charter and Municipal Code, the City Council approved guidelines recommended by the Mayor to evaluate the Recycle Plus proposals on June 27, 2000.[35]

The California Public Contract Code sections 20160 *et seq*. governs contracts awarded by cities. However, these code provisions only apply to charter cities, such as San Jose, "in the absence of an express exemption or a city charter provision or ordinance that conflicts with the relevant provision of this code." Cal. Pub. Con. Code § 1100.7. Therefore, it is unlikely that these provisions control the Norcal relationship because the language of the City Charter and

[35] The guidelines established two tiers of guidelines, with the factors in the first tier to be given more weight. The first tier considered cost evaluation, customer service, experience, and strength of operations. The second tier considered business risk and technical capability.

Municipal Code govern contracts with private entities for waste management.[36]

The Grand Jury identified five possible "ways to void or rescind" the Norcal contract: 1) material mistake of fact by one party, 2) misrepresentation; 3) concealment, 4) actual fraud; and 5) economic duress. *See* Grand Jury Report at p. 21; Appendix A-3. The legal principles applicable to each are described generally below, followed by a discussion of the issues surrounding gifts of public funds.

1. Mistake of Fact

A "[m]istake of fact is a mistake, not caused by the neglect of a legal duty on the part of the person making the mistake[.]" Cal. Civ. Code § 1577. The mistake must result from either: "[a]n unconscious ignorance or forgetfulness of a fact past or present, material to the contract" or a "[b]elief in the present existence of a thing material to the contract, which does not exist, or in the past existence of such a thing, which has not existed." Cal. Civ. Code § 1577 (1) & (2). A contract is void, or can be avoided, on the ground of a unilateral mistake that was induced by or known to the nonmistaken party. *Balistreri v. Nev. Livestock Prod. Credit Ass'n.*, (1989) 214 Cal. App. 3d 635, 640-44.

2. Fraud, Misrepresentation, and Concealment

The Grand Jury Report mentions fraud, misrepresentation and concealment as separate grounds to void or rescind the contract. The concepts of misrepresentation and concealment most relevant to this matter are included under the various definitions of fraud discussed below.

Under the Civil Code, fraud can form the basis for rescission of a contract because of lack of valid consent. *See* Cal. Civ. Code §§ 1566, 1567(3), 1689(b)(1). The fraud can be actual or constructive. Actual fraud occurs when a party to the contract, with intent to deceive the other party or induce him to enter into the contract performs one of the following acts: 1) makes a suggestion, as a fact, of that which is not true by one who does not believe it to be true; 2) makes a positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true; 3) suppresses a fact that is true and has knowledge or belief of the fact; 4) makes a promise without any intention of performing it; and 5) any other act fitted to deceive. Cal. Civ. Code §1572.

Constructive fraud is also a defense to contract formation. Constructive fraud, as a defense to contract formation, is defined by Cal. Civ. Code section 1573 as: 1) "any breach of duty which, without an actually fraudulent intent, gains an advantage to the person in fault, or any one

[36] A city can ratify an unenforceable contract by approving a contract in the manner prescribed by the city charter. *See L. A. Dredging Co. v. Long Beach*, (1930) 210 Cal. 348, 358-59. However, a city can not ratify a contract that is beyond the powers of the municipality or a contract that disregarded a required formality when it was purportedly executed. *Id.* at 359. For example, when the city is required to advertise bids, and this process is ignored, the contract can not be ratified because "[t]here is no longer any possibility of compliance with the requirement of competitive bidding." *Id.*

claiming under him, by misleading another to his prejudice, or to the prejudice of any one claiming under him[;]" and 2) "[i]n any such act or omission as the law specially declares to be fraudulent, without respect to actual fraud."

3. Economic Duress

Duress is defined by Cal. Civ. Code Section 1569, but the courts have expanded this definition to acknowledge economic duress, consisting of threats against business or property interests. *See Leeper v. Beltrami*, (1959) 53 Cal. 2d 195, 203. Economic duress consists of a wrongful act that is sufficiently coercive to cause a reasonably prudent person faced with no reasonable alternative to succumb to the perpetrator's pressure. *See Crosstalk Prods. Inc. v. Jacobson*, (1998) 65 Cal. App. 4th 631, 644. The party claiming duress must prove that: 1) the payment was made under circumstances sufficient to control the action of a reasonable person; and 2) the person in fact considered that it was necessary to make such a payment to protect his or her business interests. *Chrysler Credit Corp. v. Ostly*, (1974) 42 Cal. App. 3d 663, 678.

4. Gift of Public Funds

Article XVI § 6 of the Constitution of the State of California restricts gifts of public funds by the legislature. Article XVI § 6 states:

> The Legislature shall have no power to give or to lend, or to authorize the giving or lending, of the credit of the State, or of any county, city and county, city, township or other political corporation or subdivision of the State now existing, or that may be hereafter established, in aid of or to any person, association, or corporation, whether municipal or otherwise, or to pledge the credit thereof, in any manner whatever, for the payment of the liabilities of any individual, association, municipal or other corporation whatever; nor shall it have power to make any gift or authorize the making of any gift, of any public money or thing of value to any individual, municipal or other corporation whatever; . . .

The prohibition on gifts of public funds is applicable to acts of City Councils. *See, e.g., Albright v. South San Francisco*, (1975) 44 Cal. App. 3d 866, 869-70 (payment to mayor and council members for monthly unitemized expenses amounted to a gift of public funds).

A contract is not a gift of public funds if the contract has adequate consideration or the contract has a public purpose. Thus, "any claim of an unlawful gift of public funds is refuted if the consideration given is adequate so as to evidence a bonafide contract and further, that a public expenditure will be deemed supported by an adequate consideration if there is a public purpose served notwithstanding that private persons will benefit therefrom." *Kizziah v. Dep't of Transp.*, (1981) 121 Cal. App. 3d 11, 23 (citations omitted).

Courts have used general common law contract principles to evaluate whether a potential gift of public funds is supported by adequate consideration. *See Winkelman v. Tiburon*, (1974) 32 Cal. App. 3d 834, 845 (citing contract cases for authority when considering adequateness of consideration for a government contract). Under these principles, a court has stressed that the consideration "must be 'adequate' so as to evidence a bona fide contract" and "cannot merely be 'nominal.'" *Id.* "The law, however, does not require a weighing of the quantum of benefit received by a promisor or of the detriment suffered by the promise where the consideration is plainly substantial." *Id.*

There are not many cases considering whether adequate consideration exists for public contracts. However, the court in *Allen v. Hussey*, (1950) 101 Cal. App. 2d 457, 453, found the lease of land to a private individual for $1 a year for the purpose of maintaining an airport for the individual's profit lacked adequate consideration and therefore was a gift of public funds. The court in *Allen* explained its consideration analysis as follows:

> This is not a case, as contended by defendants, where the court "enters the boardroom" and substitutes its judgment for that of the board of directors of the district as to what is a proper consideration but is a situation in which there is no consideration at all for the lease and it is the duty of the court so to declare. The fact that the board acts in good faith does not change the matter into one of consideration, adequate or inadequate, where there is an entire absence of consideration. While the airport was to be operated as a public landing field the profit from its operation was to go to [the private individual] and not to the district or any other public agency. The benefit was to [the private individual], not merely incidentally, but it was the paramount element of the transaction.

Id. at 473-74. Noteworthy to the instant matter, the court also stated that the private individual's acts in assisting the procurement of funds for the construction of the airport could not be considered consideration because the district was under no contractual obligation to pay for such acts. *Id.*

Under general contract law principles, courts generally do not inquire into the real value of consideration as long as there is some legally cognizable value. *See Schumm v. Berg*, (1951) 37 Cal. 2d 174, 185 (the law will not enter into an inquiry as to the adequacy of the consideration). In addition, consideration does not exist when a party promises to complete a project that it has an existing obligation to perform. *Bailey v. Breetwor*, (1962) 206 Cal. App. 2d. 287, 291-92. However, if the parties agree to include additional consideration not within the requirements of an existing contract, then consideration exists. *House v. Lala*, (1963) 214 Cal. App. 2d 238, 243.

If a contract has a public purpose, "the benefit to the state from an expenditure for a public purpose is in the nature of consideration and the funds expended are therefore not a gift even though private persons are benefited therefrom." *County of Alameda v. Carleson*, (1971) 5 Cal. 3d 730, 745-46. Courts allow the legislative body to determine what constitutes a public purpose

and "its discretion will not be disturbed by the courts so long as that determination has a reasonable basis." *Id.* Further, the "concept of public purpose has been liberally construed by the courts, and the Legislature's determination will be upheld unless it is totally arbitrary." *Mannheim v. Super. Ct.*, (1970) 3 Cal. 3d 678, 690-91.

A wide variety of programs have been upheld against constitutional challenge on the ground that a public purpose existed. *See Alameda v. Carleson*, 5 Cal. 3d at 746. For example, a statutory scheme requiring a school district to pay a terminated teacher compensatory damages as part of an arbitration award was held as serving a public purpose because the legislature's determination "to promote the improvement of personal management and employer-employee relations within the public school system" had a "reasonable basis." *Paramount Unified School Dist. v. Teachers Ass'n of Paramount*, (1994) 26 Cal. App. 4th 1371, 1389.

When good faith dispute arises between the government and a private party, the use of public funds to settle the dispute is not a gift "because the relinquishment of a colorable legal claim in return for settlement funds is good consideration and establishes a valid public purpose." *Jordan v. DMV*, (2002) 100 Cal. App. 4th 431, 450 (citing *Orange County Foundation v. Irvine Co.*, (1983) 139 Cal. App. 3d 195, 200). In contrast, "[t]he compromise of a wholly invalid claim, however, is inadequate consideration and the expenditure of public funds for such a claim serves no public purpose and violates the gift clause." *Id.*

It is unclear how closely related the contract and "public purpose" need to be in order to satisfy the public policy test. One California Supreme Court case noted that that the resolutions in question were "carefully designed to assist in achieving valid public purposes" and "tailored to further the legislative purpose of supplying reasonable incentives to parties who would not otherwise provide the needed housing." *Cal. Housing Finance Agency v. Elliot*, (1976) 17 Cal. 3d 575, 585. However, since *California Housing Finance Agency*, no other reported decision has analyzed a program in terms of whether the legislation or program was carefully designed or tailored to meet the public purpose.

There is also some authority holding that a public purpose is not served if the party was already obligated to provide the services. In *Allen v. Hussey*, discussed above, the court rejected arguments based on a public benefit by having an operational airport, because the private individual was already obligated under prior contracts to operate the airport for the district under more favorable terms. *Allen*, 101 Cal. App. 2d at 474.

The Grand Jury Report states that the City was given additional consideration for the 2004 Amendment, which was suggested by the City Attorney. The additional consideration included a promise to provide up to $100,000 for a recycle characterization study, an e-scrap collection service, and provide bins for 10 additional neighborhood cleanups. *See* Grand Jury Report at p. 16. City Council members told the Grand Jury that the consideration was worth approximately $150,000. *Id.*; Appendix A-3.

Under the case law described above, it is unclear whether there was adequate consideration for the 2004 Amendment. The Grand Jury Report states that the consideration provided by Norcal in exchange for the amendment is far less than the consideration received. However, Norcal could argue that it did provide something of legally cognizable value, which arguably would satisfy the consideration requirement under general contract law principles. However, an argument also could be made the consideration is nominal and inadequate or illusory because of the small value of the services provided by Norcal in relation to its existing obligations and/or the money spent by the City.

It is also unclear whether the 2004 Amendment serves a public purpose. Waste management of a city has a public purpose under the standard. However, the Investigator is not aware of any relevant cases that have analyzed whether the public purpose test is satisfied when the consideration paid by the city clearly outweighs the benefits received, or where there is no legal obligation with respect to the payments made. In *Allen v. Hussey*, discussed above, the court rejected public purpose arguments because the private party was already under contract to operate the airport, similar to Norcal's prior contract to provide waste management services. A court could also consider public policy objectives other than waste management in determining whether the 2004 Amendment served a valid public purpose, such as settling labor issues, preventing work stoppage, and ensuring fair wages for the union members. *See* Grand Jury Report at p. 17; Appendix A-3.

What the reviewed documentation does reflect, however, is a significant effort by senior members of City staff to identify, and/or justify, a basis for providing the additional payments by the City to Norcal, even in the face of stated concerns over the appropriateness of providing any funds to Norcal. *See* Appendix A-111. Likewise, it appeared to members of City staff that the "consideration" proposed (and ultimately provided) by Norcal to the City was grossly disproportionate to the amount the City agreed to pay to Norcal. *See* Appendix A-112. The foregoing leads to the conclusion that Norcal had long been "assured" that it would receive the finds requested, with City staff being tasked to find a means thereafter to justify (rather than continue to question) the prior "commitment."

N. Whether the Mayor made false statements, impeded or otherwise obstructed justice with regard to the subject matter of the Grand Jury Investigation.

In addition to reviewing the materials provided for the purpose of determining whether credible evidence exists to support the conclusion that the Mayor violated the City Charter or the Independent Judgment Policy or related legal principles, the Grand Jury (and the City Council) suggested that the investigation consider whether the Mayor's conduct violated "other laws." In this regard, a troubling level of discrepancies exist with respect to the versions of events that have been presented. Indeed, the review of materials to date by the Investigator does not support in material respects aspects of the statements provided by the Mayor and his staff to the Grand Jury during the course of their investigation or thereafter. Further, there has been – and continues to be – a lack of candor from the Mayor and his staff towards the City Council as a whole relating to the events addressed in the Grand Jury Report. Thus "other laws" that could be implicated by the matters discussed herein are noted as follows below.

At common law, an improper act or omission by a public officer with a corrupt intent was a common law misdemeanor. *See Coffey v. Super. Ct.*, (1905) 147 C. 525, 533. Currently, the common law crime of "misconduct" is no longer recognized, "[b]ut typical situations recognized at common law and in modern statutory systems are covered by a number of sections of the Penal Code and Government Code." 2 Witkin, Cal. Crim. Law Crimes Gov. Auth. (3d ed. 2005) § 102. California Government Code § 1222 thus provides that "[e]very willful omission to perform any duty enjoined by law upon any public officer, or person holding any public trust or employment, where no special provision is made for the punishment of such delinquency, is punishable as a misdemeanor." In general, the case law interpreting this section has only applied the statute when the public officer refuses to perform a duty clearly required by his position. *See, e.g., Cassidy v. Cannon,* (1912) 18 Cal. App. 426 (public records officer may be guilty of misdemeanor when he refuses to allow inspection of records at the request of one entitled to such inspection).

Part I, title VII of the California Penal Code is entitled, "Crimes Against Public Justice" and enumerates a number of crimes that affect the administration of legal proceedings such as perjury, falsifying evidence, and bribery. In California, the crime of obstruction of justice applies only to judicial officers, court commissioners, or referees. Cal. Pen. Code § 96.5. In addition, the California Penal Code designates a number of other offenses that make it a crime to interfere with judicial proceedings. *See, e.g.*, Cal. Pen. Code §§ 132 (offering false evidence), 135 (destroying evidence), and 137 (influencing or inducing testimony). However, as discussed in more detail below, none of these provisions appear to be applicable to statements to the City Council in the absence of an oath.

Federal law makes it a crime to knowingly or willfully make "any materially false, fictitious, or fraudulent statement or representation" in "any matter within the jurisdiction of the executive, legislative, or judicial branch of the Government of the United States." *See* 18 U.S.C. § 1001. Under this statute, false statements made to federal officials conducting an investigation would constitute a crime, even if the statements were not made under oath. *See, e.g., United States v Ratner,* (9th Cir. 1972) 464 F2d 101, 103 n.2 (rejecting arguments that an exception applied if the statement was not under oath). However, whether any of the events relating to the Norcal relationship, the labor dispute or the 2004 Amendment constitute a "matter within the jurisdiction" of the federal government is beyond the current scope of the investigation. *See, e.g., Ogden v. U. S.*, (9th Cir. 1962) 303 F.2d 724, 743 ("A false statement is submitted in a matter within the jurisdiction of a department or agency within the meaning of 18 U.S.C.A. 1001 if it relates to a matter as to which the Department had the power to act").

California law does not have a similar provision that broadly prohibits false statements. Instead, the statutory framework prohibits false statements in particular instances. *See, e.g.,* Cal Pen Code §§ 532a (false financial statements); Cal Pen Code § 550 (false statement in connection with insurance claim). The California Penal Code does not have a provision that would directly cover oral false statements made at a public meeting of a City Council when the statements were not under oath. When the statements are made under oath, the perjury statute is applicable. *See, e.g., People v. Matula,* (1959) 52 Cal. 2d 591 (affirming the conviction of perjury of defendant who testified under oath before the Assembly Interim Committee on Governmental Efficiency and

Economy); *People v. Guasti*, (1952) 110 Cal. App. 2d 456 (affirming perjury conviction of sheriff who testified under oath before grand jury).

Conspiracy to obstruct justice occurs when two or more people conspire "to pervert or obstruct justice." Cal. Pen. Code § 182 (5). The elements of conspiracy are an agreement, specific intent, two or more persons, unlawful end or means, and an overt act. *People v. Martin*, (1982) 135 Cal. App. 3d 710, 721 (citing 1 Witkin Cal. Crimes (1963)). Specific intent requires an intent to agree or conspire and the intent to commit the offense which is the object of the conspiracy. *Id.* at 722. "When the offense is conspiracy to obstruct justice, as described in Penal Code Section 182, subdivision 5, it is unnecessary to demonstrate an intent to 'obstruct justice' as such; it is sufficient that the evidence shows an intent to do the acts constituting the elements of an obstruction of justice as they are described in the charging allegations of the accusatory pleading." *Id.* It is not necessary to show an evil or corrupt motive. *Id.*

The Supreme Court of California has given the statute proscribing obstruction of justice a relatively broad interpretation. The term "pervert or obstruct justice" has been held to mean offenses constituting a violation of the statutes contained in part I, title VII of the Penal Code ("Crimes Against Public Justice") and any other acts that would have been considered offenses against the administration of justice at common law. *Lorensen v. Super. Ct.*, (1950) 35 Cal. 2d 49, 59 (holding that Cal. Pen. Code § 182 (5) was not constitutionally vague). "Generally speaking, conduct which constitutes an offense against public justice, or the administration of law includes both malfeasance and nonfeasance by an officer in connection with the administration of his public duties, and also anything done by a person in hindering or obstructing an officer in performance of his official obligations." *Id.* at 59.

This obstruction of justice provision may be applicable to an agreement between parties to hinder the Mayor, City Council, or Grand Jury in the exercise of their official duties. For example, In *People v. Martin*, 135 Cal. App. 3d at 721-23, the court upheld a conviction for conspiracy to obstruct justice based on the agreement between a judge and attorney to improperly dispose of misdemeanor DUI cases without the consent or knowledge of the district attorney's office. The conviction was upheld even though the evidence did not show that the judge received money or favors from the attorney. *Id.* at 722.

A grand jury has the power to initiate a proceeding to remove a public officer for misconduct. California Government Code § 3060 provides that "[a]n accusation in writing against any officer of a district, county, or city… for willful or corrupt misconduct in office, may be presented by the grand jury of the county for or in which the officer accused is elected or appointed." The proceeding is not criminal in nature because it does not result in the conviction of a crime but merely to remove the official from office. *See People v. Hale*, (1965) 232 Cal. App. 2d 112. The procedure for the accusation is similar to a criminal trial, including trial by jury. *See generally*, Cal. Gov't Code §§ 3063-3064. The statute and the case law do not clearly define what is required to remove the public official from office. The "misconduct" does not need to constitute a violation of any specific criminal statute. *People v. Harby*, (1942) 51 Cal. App. 2d

759, 767. However, the cases have not made clear "when conduct that falls short of violating a statute or ordinance will support a charge of 'official misconduct.'" 2 Witkin, (3d Ed. 2005) Cal. Crim. Law Crimes Gov. Auth. § 110. Mere negligence is insufficient. *See Steiner v. Super. Ct.*, (1996) 50 Cal. App. 4th 1771 (Orange County supervisors who made risky investments resulting in county's bankruptcy did not engage in acts constituting willful misconduct).[37]

8. RECOMMENDATIONS RE: FURTHER INVESTIGATION

As the initial scope of the investigation was limited, as described above, there are many factual issues with respect to which additional information in the form of witness statements under oath may provide a different conclusion, or shed light on issues that could not be fully resolved. While there is no guarantee that any witness will cooperate,[38] or be able to provide information that will assist the purpose of the investigation, to the extent the City Council believes that the investigation should continue further, obtaining witness statements under oath is recommended.[39] As the Investigator does not have independent power to issue subpoenas to compel testimony or the production of documents, the City Council will have to consider the extent to which it will direct the City Attorney to issue subpoenas as requested by the Investigator.[40] From our review of the materials made available to date, a non-exclusive list of the individuals from whom statements could be sought is set forth in Appendix C.[41]

Respectfully submitted,

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[37] On August 19, 2005, Dale Warner, a private individual, sent an application for accusation to the Santa Clara County Civil Grand Jury. Appendix A-113. The application requests that the Grand Jury issue an accusation under Cal. Gov't Code § 3060 for the Mayor's acts relating to Norcal and several other unrelated events. However, to the knowledge of the Investigator, the Grand Jury has not issued an accusation.

[38] Counsel for Norcal already committed, in correspondence with the Grand Jury subsequent to issuance of its Grand Jury Report, that Norcal will cooperate to answer further questions. Appendix A-114.

[39] A list of potential witnesses to be interviewed in connection with a further investigation is set forth at Appendix C.

[40] During the September 13, 2005, session before the City Council, it was noted that the City would not delegate to the Investigator subpoena authority. Subsequent conversations with members of the City Attorney's office have indicated that it may issue subpoenas at the direction of the City Council in furtherance of any further investigation. In addition, there apparently are a number of individuals with information relevant to the investigation who may only be willing (because of, *inter alia*, the fear of reprisal) to provide such information on the condition that their identity remains confidential. The City Council, should it decide that further investigation is appropriate, should also consider whether the Investigator will be allowed to accept and consider information when offered contingent upon such conditions.

[41] At the request of the City Council, the Investigator will provide an estimated budget reflecting the significant fees and costs required to engage in a further factual investigation that would include interviews of some or all of these individuals under oath.